FLASH REPORT

ON KEY ECONOMIC AND FINANCIAL DEVELOPMENTS BASED ON 2004 AND 2005 JANUARY-FEBRUARY DATA

Budapest, 2005. április 6.

KEY INDICATORS AND RATIOS

2002 - 2005

Description	2002 actual	2003 preliminary actual	2004	2005 expected
	comparison to preceding year, as a percentage, t comparable prices			
Gross domestic product (GDP)	3.5	3.0	4.0	3.5 - 4
G D P domestic absorption	5.4	5.4	3.3	3.5 - 4
of which: household consumption	9.3	7.6	2.8	3 - 3.5
gross fixed investment	8.0	3.4	8.3	5 - 7
Foreign trade turnover				
Exports (goods and services)	3.7	7.6	15.7	10 - 12
Imports (goods and services)	6.2	10.4	14.0	10 - 12
	change compared to preceding year. as a %			
Gross average earnings	18.3	12.0	8.2*	6 - 7
Net average earnings	19.6	14.3	7.1*	8 - 9
Per capita real wage	13.6	9.2	0.3*	4 - 5
Number of employees	0.1	1.3	-0.5	kb. 0.5
Unemployment rate (ILO), %	5.8	5.9	6.1	6.1 - 6.3
Consumer price level, year's average	5.3	4.7	6.8	3.5 - 4
	at current prices. in EUR billion			
Foreign trade deficit, Bn EUR	3.4	4.2	3.8	4 - 4.2
Current account deficit, Bn EUR	4.9	6.4	7.1	7.2 - 7.5
	percentage of GDP			
General government deficit - ESA95 **	8.5	6.2	4.5	3.6
Current account deficit	7.2	8.7	8.9	8.3 - 8.6

*/ In the budgetary sector this is adjusted with the effect of the modification of the rule on one month's additional remuneration

**/ Adjusted with the effect of the pension reform

Introduction

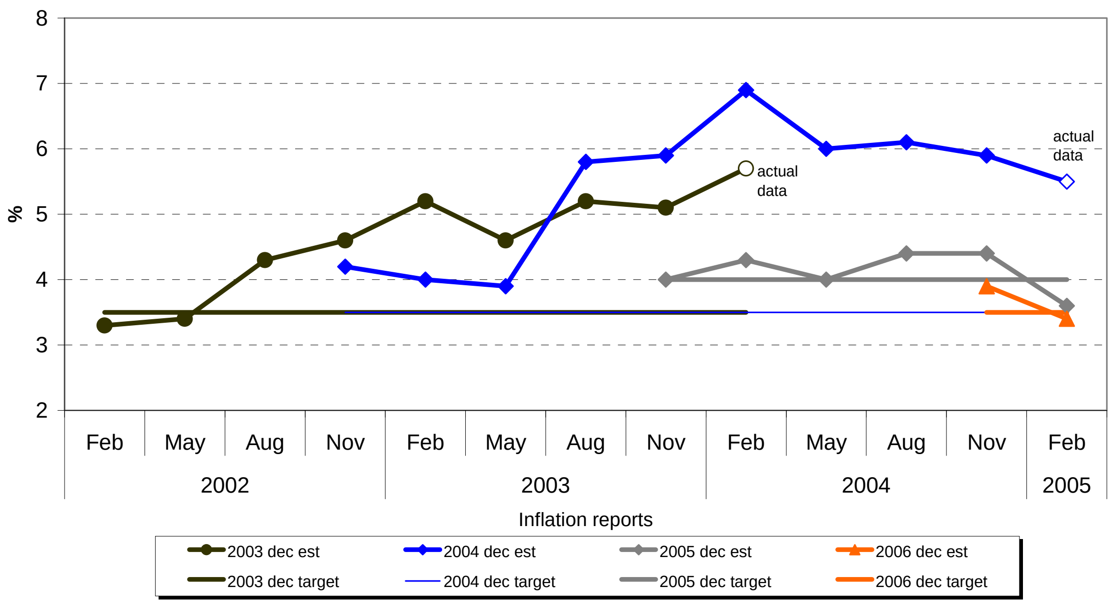
In terms of economic policy the most important event of year **2004** was that the Hungarian economy **returned to a macroeconomic path**, characterised by **sound and sustainable growth in a long run**. **GDP growth accelerated** from 3 % in 2003 **to 4 % in 2004.** This acceleration was determined by the 15.7 % growth of exports and a substantial, 8.3 % expansion of investment. The growth rate continued to exceed the EU average by 2 percentage points, indicating that the process of catching up has not been broken. It is favourable that exports and investments founding future development became the main engines of growth again, after the 2002-2003 period dominated by processes in the other direction, whereas the growth of consumption fell short of that of GDP.

This positive structural change was highly facilitated by the **budget adjustment** which contributed at the same time to the exploitation of the upswing in the world economy throughout the year. The outstanding extent of the general government deficit reduction even in comparison to other Member States was a result primarily of the fact that the growth of expenditures did not keep up with that of GDP, while their structure also changed considerably. The share of spending on wages declined perceptibly within the total expenditure. These changes - entailing effects reducing demand - greatly facilitated the deceleration of household consumption, resulting in the restoration of the balance between household consumption and GDP growth . At the same time the structure of employment also improved. The impacts of tax increases triggering temporarily higher inflation in 2004 might also quickly fade out, allowing the disinflation to continue in 2005 in line with the previously observed trend.

The external financing need of the economy diminished and its structure also improved substantially - the influx of foreign direct investment picked up.

As a consequence of some serious problems encountered in 2003 economic policy makers had to tackle with **notable lack of confidence** in early 2004. The figure concerning the year 2003 deficit had to be revised in a few days after its official announcement. After a serious overshooting in respect of the inflation target in 2003 emphasis has been laid by monetary policy on eliminating the effects of price increases - caused by indirect tax increases - influencing expectations and on reaching an inflation target of 4 % in 2005.

Inflation targets and their achievement



Fiscal policy had to face a lack of credibility and an over ambitiously set target concerning the general government balance, particularly in view of the actual figures on 2003. The change in financial governance and a more realistic deficit target for 2004 triggered a slow improvement in investors' confidence and a decline in the expected interest premium.

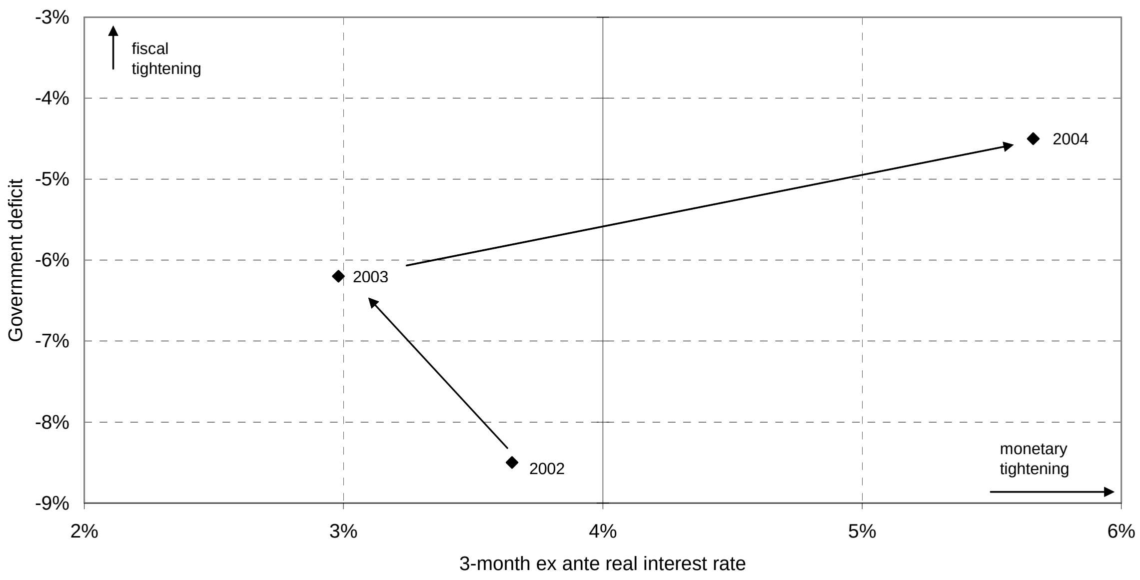
The Government modified its target concerning the general government deficit in September, when it became apparent that EU accession had a larger than expected one-off impact on budget revenues and any further budget adjustment would have jeopardised Hungary's growth potentials. Despite the fact that the target was modified twice during the year, investors' confidence improved steadily throughout the year. In addition to the general improvement experienced in emerging countries it was also a result of the substantial improvement in the aggregate and the primary balance of general government, the resolute measures taken to reduce the expenditures and the widespread improvement of the macro-economic processes in the wake of the budget consolidation.

In terms of its measures monetary policy responded to the tightening fiscal policy and the improvement of fundamentals of the economy only at a substantial lag: actions to reduce the base rate were taken only after a definite improvement in the market sentiment. However, the slow and gradual interest rate cuts followed the market expectations only, resulting a gradual strengthening of the Forint accompanied by a relatively modest volatility.

Year 2004 was, on the whole, characterised by **tightening financial policy conditions**. Fiscal policy was tightened substantially during the year, however, the distrust that was characteristic of the markets decreased only gradually. Experience during recent years showed that besides the actual achievements of fiscal policy markets consider the accomplishment of the declared targets as equally important. The latter is the most important aspect of the credibility of economic policy.

The increasingly tight financial conditions and the delay of an upswing in the international economic environment resulted in a **faster than expected decline of inflation** which was also reflected by several downward adjustments of price projections. Consequently, despite the diminishing nominal interest rates both elements of monetary conditions - real interest and real exchange rates - tightened during the year. Stricter financial policy conditions imposed tougher requirements for the business sector on both the demand and the cost side. The growing rate of unemployment and - despite the accelerating growth - the fact that the economy were growing under its potential indicated that the tight monetary conditions produced output loss in 2004, which applied particularly to sectors of high labour intensity and high added value.

Developments in financial policy conditions 2002-2004



It is too early to draw conclusions for the whole of this year from information available on 2005 to date. The following trends seem likely to unfold in view of conditions that are currently observed and that can influence economic processes.

Reducing the deficit continues to be the main fiscal policy target. Implementation of the budget adopted on the basis of principles set in the Convergence Programme is - despite the existing risks - a prerequisite for the stabilisation of growth processes that can be sustained in a long term. Furthermore, attainment of the budget targets may significantly improve the international views taken of the credibility of the Hungarian economic policies. An increasingly tightly controlled budget provides businesses with a wider manoeuvring room, however, this alone will not result in a higher growth of investment, output and GDP in comparison to the high basis in 2004.

In the first quarter of 2005 monetary conditions developed in the same way as they did earlier. Up to mid-March the international financial conditions were becoming increasingly favourable for the whole of this region. As a consequence of the favourable data on inflation in early 2005 and that of the substantially reduced inflationary forecaststhe real interest rates and real exchange rates remained at a high level and monetary conditions were not eased to any definite extent despite the 175 basis points interest rate cut at the beginning of the year. The fact that prices expected to grow at a substantially lower rate by the end of the year than the 2005 inflation target implies that monetary policy failed to fully take into account the effects of fiscal policy restraining demand, or the slower growth of wages than that of productivity, or indeed the speed of adjustment of the inflationary expectations and of the real economy.

The **financial policy conditions of 2005** depend primarily on the restoration of the creditworthiness of economic policy and on the coordination of economic policy and monetary policy. Fiscal policy has established the goals required for the **restoration of confidence**. The most important now is that these goals should be fully accomplished. Should any risk emerge in relation to the accomplishment of the goals or should any deviation from the pre-determined path be observed, the required measures need to be promptly taken. The confidence building effect of the measures taken in order to improve the primary balance is reflected in the improvement of the general government balance on an even larger scale, as a result of the drop in interest expenditures enabled by the reduction of interest premia.

From among the currently visible **risks** economic policy makers have to take account of the uncertainty of the future trends of economic growth in West Europe along with further unfavourable development of oil prices (primarily through its effect on growth in Europe). Though economic growth in the countries of the Eurozone has decelerated somewhat, yet since their demand for imported products is not slowed down to a like degree, this trend does not have a negative effect on the faster than average growth of Hungary’s exports.

Consequently, even despite the existing risks, it is reasonable to assume that the economy of Hungary may continue to develop on a sustainable growth path **in 2005** characterised by export driven growth of a rate qualifying as ‘high’ even by international comparison.

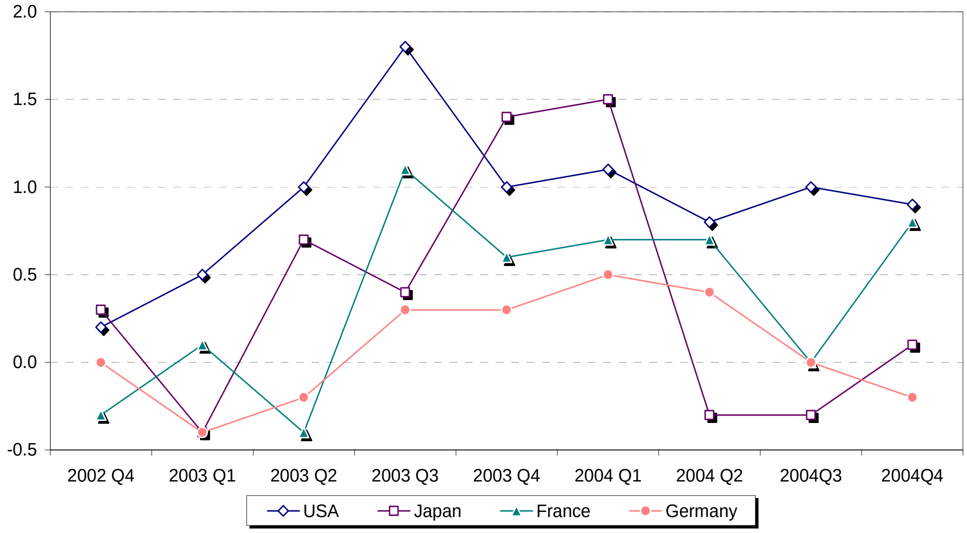
1. External economic environment

After a downturn that lasted for several years before 2003, the global economy embarked on rapid growth in late 2003 and early 2004. In the case of the USA and Asian countries - except Japan - constituting the main engine of growth this trend continued during the rest of the year. The performance of the EU countries improved at a certain lag and at a slightly lower rate. In contrast to previous projections and expectations the growth of the economy picked up in a wider range both in terms of sectors and the regions involved. This however, was not enough for a breakthrough in the leading economies of the European Union. The economic upswing remained moderate in the EU, indeed, the growth accomplished during the fourth quarter fell short of expectations. Exceptions to this trend were France and Spain, where a temporary deceleration in the third quarter was followed by increased dynamic in the fourth quarter, while Germany observed a decline from the rates achieved in preceding quarters.

Acceleration of growth in the first half of 2004, followed by a slight deceleration

Real GDP growth

Percentage changes from previous period, seasonally adjusted, at quarterly rates



More intensive growth, dominating the development of growth across the globe, is expected to take place in the USA and the Asian region in 2005 again. The dynamic of growth indicators is expected to diminish somewhat but they continue to be positive. Accordingly, the growth of the economy of the US may continue in a short run but analysts expect it to fall short of the long term average.

Perspectives in 2005 continue to be most favourable in the USA and Asia ,…

Continuation of a moderate rate of growth seems likely in the European Union. The situation is somewhat more favourable in France, Britain and Spain. By contrast, the early 2005 economic indicators of Germany failed to resolve contradictions observed in the economic processes. The German economic indicator ‘ZEW’ has been growing for three months and in March it reached a several months’ high. This growth may project a boom in domestic demand whose low level has been blocking growth for some time. By contrast, the most important German economic indicator, IFO, has been declining during the recent

… with uncertainties about an upturn in the EU

three months, showing a deceleration of growth in Germany, indicating a 'flattening' of the growth curve. Business atmosphere has been deteriorating in the manufacturing industry as well as in the retail sector and the expected boom of investment demand failed to materialise. The favourable external economic environment should facilitate growth across the European Union but oil prices and the strong Euro have a contrary effect. Furthermore, the low interest rates and the expansion of income generation should continue to provide favourable financing conditions for economic growth. The dynamic of the growth of new Member States continues to be intensive despite the expected slow-down.

Risks: high oil prices and strong Euro

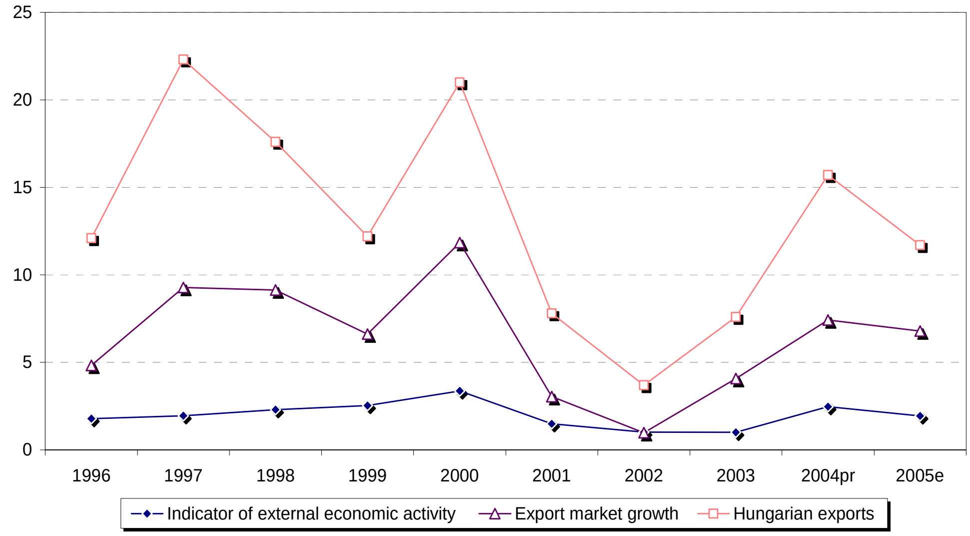
The development of oil prices - in view of their high levels and hectic fluctuations - continues to be the dominant risk factor from the aspect of the global economy. Brent oil prices hiked to a new high in March at 56 dollars - after the previous peak in the autumn of 2004 - and no oil price drop is expected for the time being. The economic growth of the Euro zone has been also unfavourably influenced by the strong Euro for quite some time. (In March the ECB reduced its growth projection of this year for the Euro zone from the previous 1.4-2.4 % to 1.2-2. %. The EC cut its projection from 2.0 % to 1.6 %.) Some change may take in the wake of the interest rate increase introduced by the FED on 22 March, especially if the interest rate rises are continued. This may ease the appreciation pressure on the Euro that has been influencing processes for quite some time.

The economy of Hungary exploited the favourable external economic environment

In 2004 Hungary managed to take advantage of the favourable external economic environment. The growth of the economy of Hungary - which exceeds that of the Euro zone by 2.0 percentage points - resumed its export driven path from the third quarter of 2003. As a small and open economy, Hungary is very responsive to the development of the external economic environment. Hungary's exports are influenced primarily by the development of the import demand in our key export partners and not so much by the development of their own GDP growth. The growth of the imports in these countries may be substantially faster than that of their GDP and this may have a positive impact on Hungary's exports as well.

Volume of exports,external economic activity and export market growth

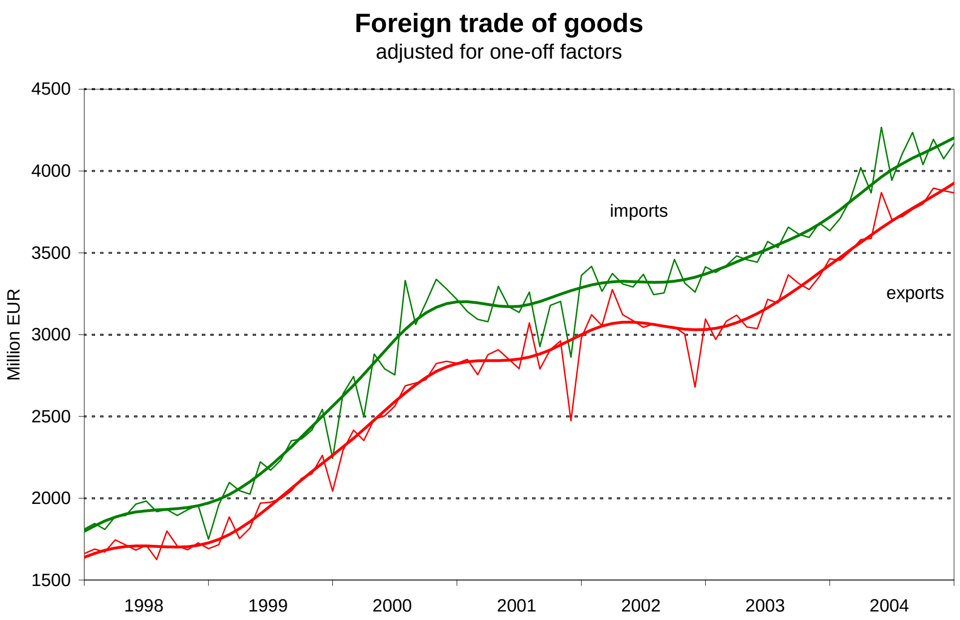
percentage changes from previous year



2. Growth factors

2.1 Foreign trade

As a consequence of the favourable external economic environment the foreign trade of goods started to grow vigorously from mid-2003. Seasonally adjusted trends indicated a steady expansion of exports and imports, with a growth rate of exports consistently exceeding that of imports during each quarter of the year.



Box 2.1

Changes in methodology of foreign trade statistics

The system of foreign trade statistics and its releases has been changed since May, in the wake of Hungary's EU accession. During the first months after the introduction of the new system the reliability of statistics deteriorated: major adjustments to figures took place on several occasions. The situation was further complicated by the alteration of statistical releases since in contrast to previous practices the first statistical data comprise a macro-estimate of the expected actual data. The second release contains detailed statistical data which are quite naturally lower than those published first, as they are built up from elementary data. In the second half of the year the final actual data were almost identical with the first estimate, with a positive adjustment of an average of 1.7 and 0.2 % in the case of export and import figures, respectively.

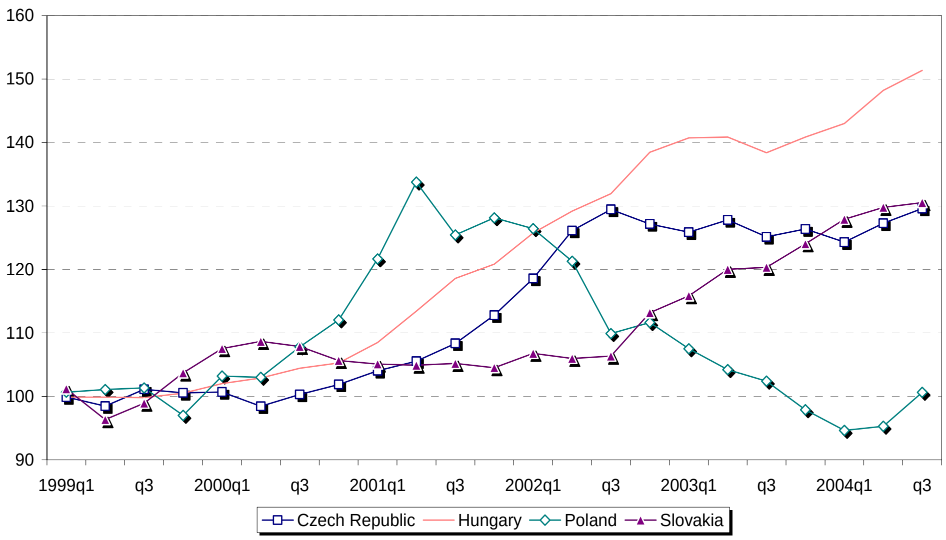
The assessment of import processes has been complicated by some one-off factors relating to Hungary's EU accession. The months of March and April saw advance imports worth some EUR 350 million. The value of EU import items in transit (imports in progress and the customs clearing of goods imported from the EU) amounted to HUF 295.5 billion between May and November. A review by the Central Statistics Office (CSO) found that statistics already contained HUF 109.2 billion of the total of HUF 295.5 billion (comprising mostly materials for contract work). The value of imports was adjusted for this figure in the CSO data release on import at the end of the year.

In the first half of 2004 **exports** increased by 1.3 % on a monthly basis (compared to the preceding month). From the third quarter on - and particularly in December - this rate slowed down somewhat. The figure on January, however, shows that exports picked up again. The temporary slowdown was related to the deceleration of the external economic environment, particularly the slowdown of the EU countries and the deterioration of competitiveness also contributed to the lower growth in the second half of 2004. In terms of unit labour cost the deterioration of the position - observed ever since 2001 - has continued compared to the Visegrád countries (Czech Republic, Hungary, Poland and Slovakia). In relative terms the changes of exchange rates and prices together caused a decline of the income position of exporting firms, particularly SMEs.

Exports and imports picking up again in early 2005

Real effective exchange rate based on ULC

Average 1999 =100



The monthly rate of **import** growth exceeded that of exports by a modest 0.1 % during the first half of 2004. This trend was, however, influenced by a variety of one-off factors. From the second half of the year the growth of exports slowed down substantially (to a monthly average of 0.7%). On the one hand it was a consequence of advanced imports earlier in the year, while on the other it was a result of a stagnation of investment in the fourth quarter and a lower growth rate observed in the second half.

Trade deficit increased significantly during the months preceding Hungary's EU accession, particularly in April, owing to advanced imports. Thereafter the trade deficit shrank steadily in each month with the exception of September. During the whole of the year the deficit amounted to EUR 3,847 million, some EUR 321 million down from the preceding year's figure. The balance of foreign trade with the EU Member States as well as non-Member States in Europe improved substantially, while the deficit in the trade relations with Asian countries expanded rapidly as a result of the increase of goods imported for export purposes.

External equilibrium improved owing to processes in the real economy

The imports of machinery was the dominant factor

The volume of exports increased by about 17 %. In terms of its structure the process was dominated by a 22 % expansion of the exports of machinery which accounted for three quarters of the increase of exports. The exports of communications products, particularly the sale of mobile phones increased especially vigorously. The volume of the exports of manufactured goods expanded by 10 % through a major increase of the export of drugs.

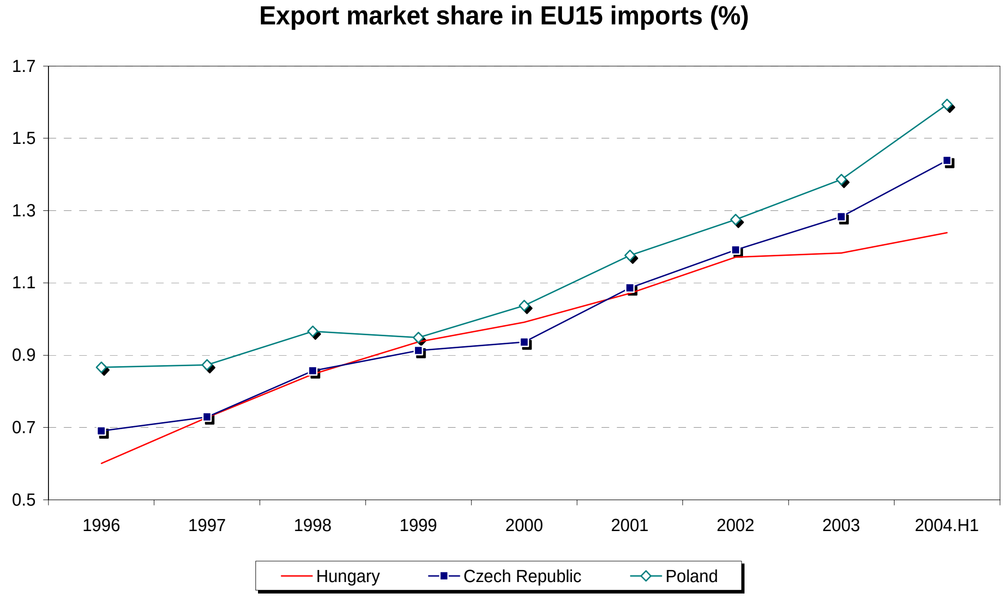
The volume of imports expanded by almost 14 %; within the 20 % growth of the imports of machines and transport equipments the imports of electrical machines and devices, power generating machines and equipment for investment purposes as well as communications products for eventual export purposes grew exceeding the average growth rate. The 28 % import growth of passenger cars - in terms of HUF - was the dominant factor in the importation of road vehicles. The volume of the imports of manufactured goods increased at a rate (7.4 %) below the average, however, the import of metal products for export purposes grew substantially. The imports of foodstuffs, beverages and tobacco products expanded by an outstanding 24 %. The volume of fuels stagnated but in terms of Euros their import increased by 8 % owing to price rises.

Deteriorated terms of trade

Terms of trade deteriorated by 0.7 % for Hungary. A smaller part of the price loss was caused by the increase of energy prices while the larger part was a result of the differences in the structure of machine exports in relation to the EU15 countries.

In terms of country groups the volume of exports to the European Union increased by 13.8 %, that of imports grew by 6.3 %. As a consequence of the growth of exports steadily and substantially exceeding the growth of external demand, Hungary’s market share of the OECD and the EU15 countries increased during the period under review. Hungary’s relative position - compared to the Czech Republic and Poland - has been deteriorating since 2001 and this trend was not turned around by the figures of the first half of 2004. The export performance during the second half, however, may improve the relative position over 2004 as a whole.[1]

[1] Comparative figures are available only for the first half of 2004



Hungary's trade with the new Member States expanded significantly: exports towards these countries and imports from them grew by 29 % and by almost 19 %, respectively. In respect of countries outside the European Union the volume of both exports and imports increased at rates exceeding the average: by 30 % and 37 %, respectively. Almost 70 % of the export increment was taken up by EU markets, while two thirds of the growth of imports came from countries outside the Union.

Risk: uncertain external economic environment

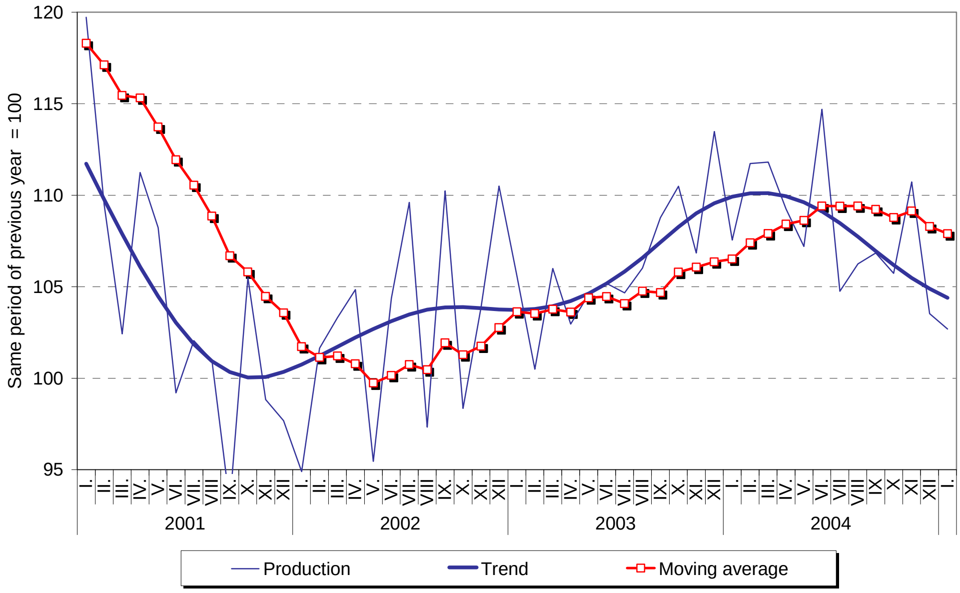
Risks may be encountered in 2005 primarily in terms of the external economic environment. The development of Hungary's exports hinges primarily on the development of demand in the Member States, i.e. the economic outlook of EU countries has a fundamental impact on the economy of Hungary both in a short and long run. A diversification of our markets could loosen this dependence: external equilibrium could be improved by boosting Hungary's exports to the dynamic Asian regions and the Russian markets. Despite the modest external demand there seems to be a case for a 10-12 % increase of exports which is confirmed by the 14 % expansion of exports in the last quarter of 2004 and the acceleration of exports in January 2005. Imports may increase at a rate equalling or falling slightly short of exports, depending on the trend of investment in the business sector. This may result in a EUR 100-300 million increase of the trade deficit but this is expected to be balanced for the most part by a likely surplus on services. On the whole therefore, real economic processes are not expected to lead to a deteriorating external equilibrium.

2.2 Output

The growth of industrial output decelerated

The 8.3 % growth of **industrial output** (including a 9.3 % increase in manufacturing) was driven by a 15.7 % increase of export sales, while the level of domestic sales remained unchanged. The trend of industrial output increased in the first quarter of 2004. This was followed by a downturn which could not be offset even by a 2.7 % growth in January 2005.

Volume indices of industrial production

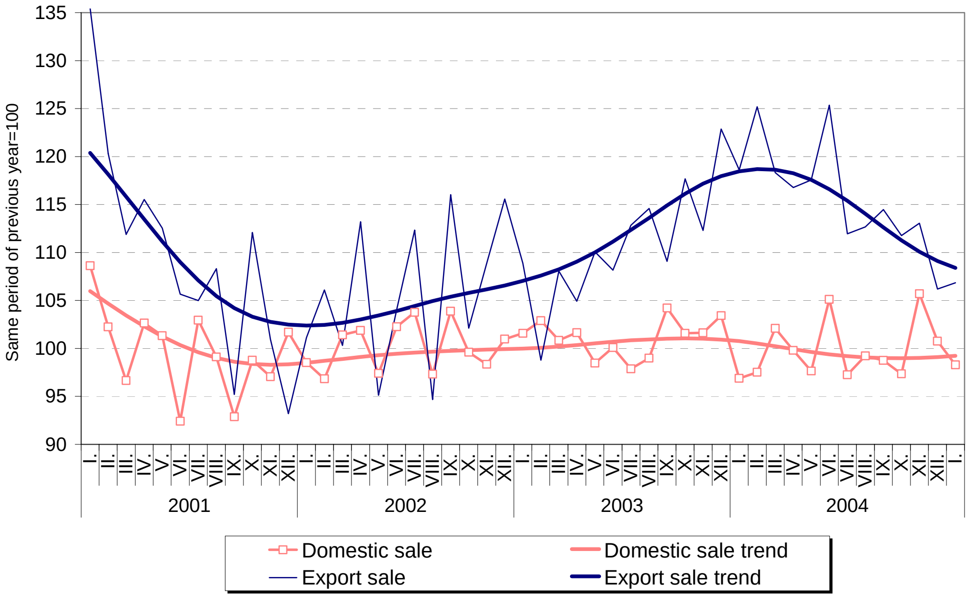


Industrial production continued to be driven by exports even in January, even though at a diminishing rate: the almost 7 % expansion of exports was accompanied by an almost 2 % diminishing of domestic sales.

Weakening dynamic of manufacturing exports, stagnating domestic sales

The trend of exports of manufacturing enterprises operating with more than four employees has been decreasing steadily since the 21 % high in March 2004. In January the growth rate was at 8.4 %. The domestic sales of the same sector stagnated throughout the whole of 2004. The volume of exports of electrical equipment - accounting for almost 45 % of the total exports of the manufacturing sector as a whole - increased by 13.3 % in January, while domestic demand for the output of the same sector has been growing even more dynamically for months now (by over 47 % in January alone). Manufacture of transport equipment, which is another important exporting sector - equalling about half of electrical equipment - increased its sales abroad by a mere 3 % in January.

Volume indices of sales in the industry



Industrial productivity improved by almost 9 %

The productivity of industry in terms of value added increased in 2004 twice as fast as the average improvement recorded in the national economy. In the whole of industry value added increased by 5 %, that of the manufacturing grew by 6 %. At the same time the growth of value added slowed down in the second half and the number of employees dropped in each quarter. The productivity of industry improved yearly by 6.5 % between 1995 and 2004, at the same time the manufacturing sector showed a 8 % improvement. These figures were exceeded by the rates observed in 2004.

Productivity

(GDP/number of employees)

corresponding period of preceding year = 100

Year/quarter	National economy	of which: industry	of which manufacturing
2004.			
I	103,5	110,1	*111,3*
II	104,9	110,1	*111,1*
III	105,0	106,7	*107,3*
IV	105,0	108,4	*108,9*
Year, total	**104,5**	**108,8**	***109,5***

Trend of new orders calling for caution

The expansion of the stock of orders slowed down somewhat last year, as a consequence of the dwindling number of new orders. The index of new orders placed in January was somewhat higher, primarily owing to two sub-sectors: new export orders increased by 11 % in the electrical equipment and instruments sector while new orders registered in the sub-sector of machinery and equipment soared by almost 150 %. at the same time new orders for exports in the manufacture of transport equipment was down 17 % from the level observed in January 2004 (which was still a relative boom period for this industry). Demand for the output of the chemical manufacture - including the pharmaceutical sub-sector - fell short of the preceding year's level by 19 %, while foreign demand for products of the metallurgical manufacture stagnated.

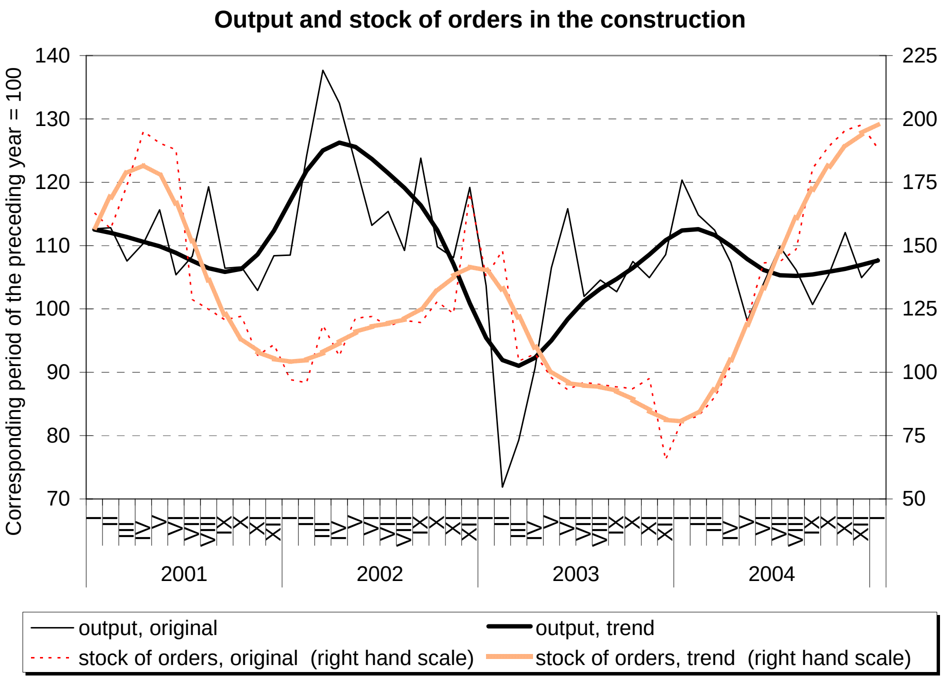
The development of external economic growth is a key factor influencing this year's industrial output. Forecasts are indicative of a mild downturn in the European Union. Confidence indices summing up the opinions of domestic businesses, worked out by various institutions, are also indicative of slightly pessimistic business expectations. One specific risk factor is whether the 'mono-cultural' Hungarian exports - dominated by the manufacture of machinery and electrical and non-electrical equipment - will manage to secure markets for our products of higher GDP content.

Assumptions and forecasts for 2005

The year 2005 forecast on industrial output has been worked out with a view to the uncertainty lying in the development of external economic trends. The projection concerning new orders includes a 5-7 % monthly growth rate along with a wider range of sectors involved in exporting. In view of the high basis of 2004 a slightly less spectacular growth of 6-8 % is expected for 2005.

The upward trend of construction …

The output of **construction** exceeded the previous year's performance by 6.8 % in 2004. After the high growth in the first quarter last year the growth of the sector slowed down and then it accelerated in the last months of the year again. This was confirmed by the 7.9 % growth recorded in January 2005, driving the trend rate to 7.6 % in January.



… is determined primarily by infrastructure development

Growth continued to be driven primarily by the road network construction projects. This is also reflected by the fact that the volume of the civil engineering works exceeded the extremely high basis of last January by 9 %. Moreover, even the volume of the construction of buildings increased by 7 %.

projects

New contracts declining, stock of orders still impressive

During the previous year the volume indices of new contracts varied greatly from month to month in a relatively high range (between 120 and 220 %). December 2004 was the first month when the growth rate dropped by 18 %. By the month of January - perhaps as a result of a counter-effect of the high initial level in January 2004 - the index decreased by an even more dramatic rate exceeding 40 %. The aggregate result was a consequence of the combined effect of a 70 % decrease of new contracts for civil engineering works and an almost 50 % expansion of buildings. The end-2004 stock of orders was far more favourable than the trends described above: the stock of orders for civil engineering works and for buildings was still 125 % up in January on the level registered one year before.

The output of the construction is expected to grow by 6-7 % this year

This year's output in the construction will - primarily owing to the run-out of the residential construction boom - be dominated by the development of infrastructure investments. The dynamic of residential construction is expected to decline, yet the first half of the year is expected to be characterised by a vigorous growth rate. A slight deceleration of the dynamic of the overall output of construction is expected for the first half, to be followed by an upswing in the second half of the year. On the whole, the output of the construction is expected to be just as dynamic this year as was observed in 2004.

Agricultural output was up more than 20 % in 2004

In year 2004 **agriculture** performed exceptionally well: the grain harvest of cereals exceeded the average of the period between 1996 and 2000 by as much as 40 % in 2004. With the exception of sheep, livestock declined in all subsectors. The value added by the sector in 2004 increased by 36 % (along with a 23 % growth of output).

In the procurement of agricultural products the turnover of cereals and fruits doubled in January while that of animal products was down 6 % from last year's level: consequently, procurement fell by 2 % as an aggregate.

The prices of agricultural products increased by an average of 4.5 % while the sector's input prices soared, by more than 30 %. The producer price level of the sector in the month of January was, however, 13.3 % up on the level booked a year ago, while the price of products and services used for production also dropped (by 2 %). In January the agricultural price gap shrank in comparison to the ratio observed in 2004.

The sector's performance in terms of field crop production could be accomplished this year again only under extremely favourable weather conditions. At the same time the diminishing of livestock is expected to continue. According to the most optimistic expectations the sector may repeat last year's performance this year.

Substantial growth of transport performance in terms of freight-

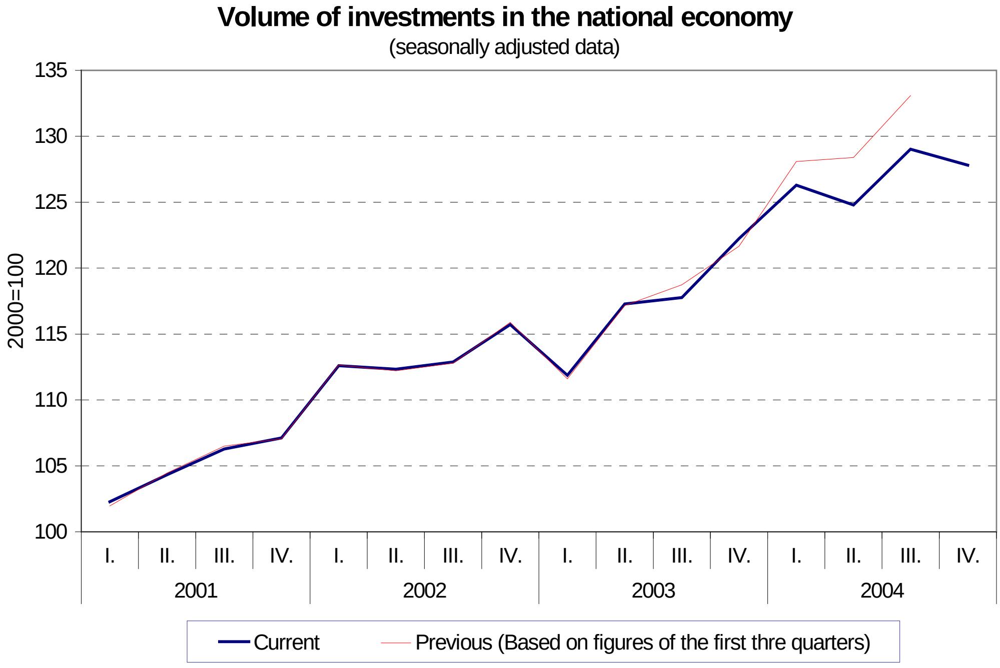
The **transport** sector delivered a smaller quantity of commodities to a larger distance, as a consequence of which its performance in terms of freight-tonne-kilometres increased by 11.5 %. Deliveries to destinations abroad grew much more dynamically than domestic transport. International transport of commodities was focused on roads while domestic transports took place mainly on rail.

tonne-kilometres

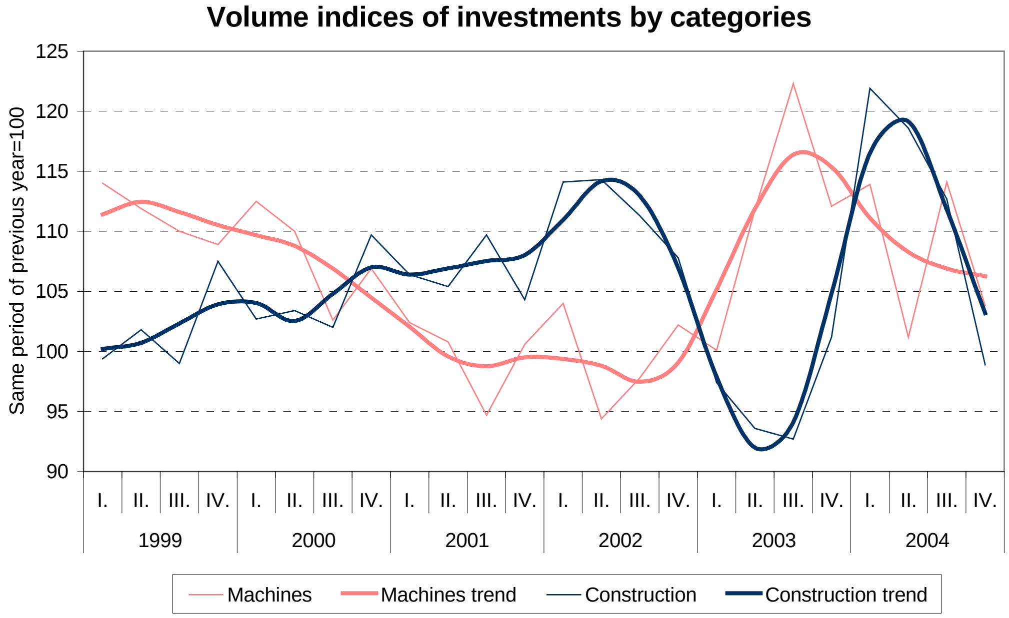
2.3 Investment

Almost 8 % growth of investment

The volume of **investments** in the national economy expanded in 2004 by 7.8 %, despite analysts' expectations of over 10 % growth. The trend of investments was extremely favourable in the first three quarters (13.2 % up), but this was followed by a dramatic drop in the last quarter (to 0.3 %). The decline in the fourth quarter would not be surprising in itself since the outstanding growth rates observed in the first and the third quarter had to be followed by a slower period. The rate of the decline was, however, so substantial, that it resulted in a fundamental change of the trend expected to follow from the figures of the first three quarters for the whole of the year.

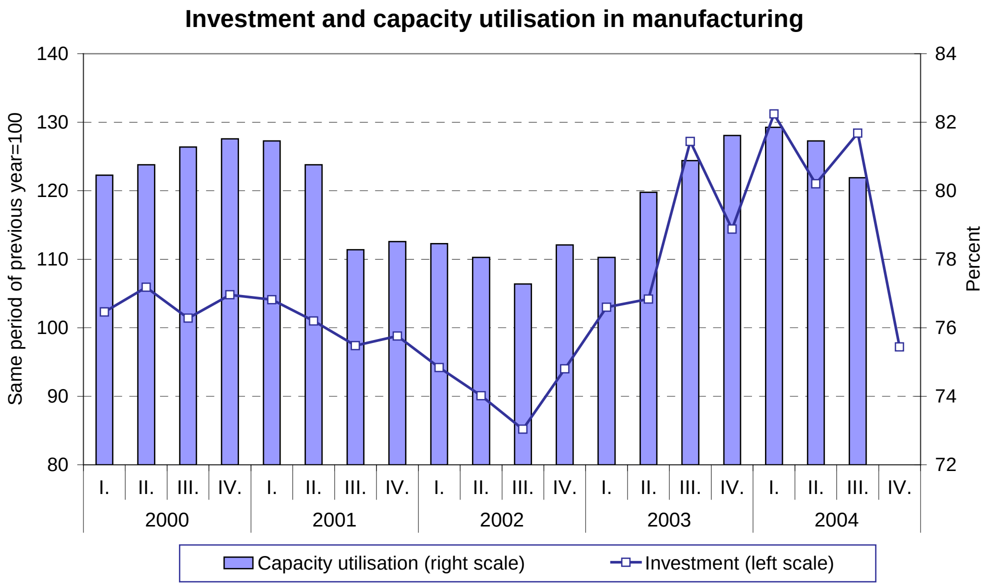


An assessment of the investment structure leads to the conclusion that investments in construction dominated the whole of the year (showing an increase of 9 %) while investment in machines and equipment expanded by 7 %.



Investment projects in the manufacturing sector - an essential requirement for acceleration of economic growth - expanded by 15.3 % in the whole of 2004 but the last quarter of the year was characterised by a 3 % drop. The degree of utilisation of capacities was between 80 % and 82 % in the past year so the future scarcity of capacities does not seem to be threatening. A very substantial contribution was made to the investment performance in the whole of year 2004 by the 15.2 % growth recorded in the transport sector (comprising motorway construction projects) and by the 13.1 % delivered by real estate transactions (comprising residential construction as well). At the same time, investment in agriculture was substantially (by 23.7 %) below the corresponding figure of the preceding period. The support system - having a profound effect on the value of agricultural investments - was radically transformed as a consequence of Hungary's EU accession, resulting in a significant contraction of the range of projects eligible to support.

The manufacturing industry, motorway and housing construction delivered high investment performance in the whole of 2004



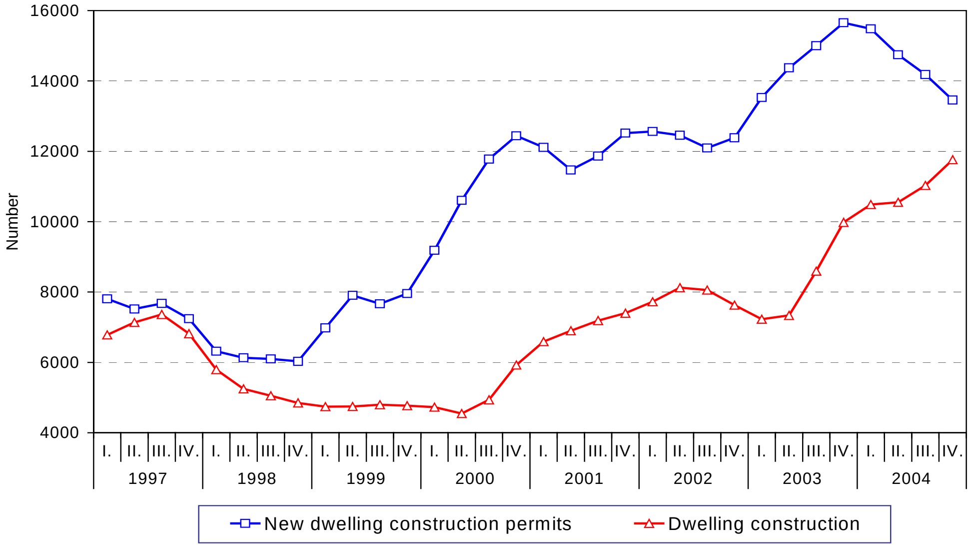
source: Kopint

Dwelling construction peak

2004 was the year during which the largest number of new dwellings - 44,000 new homes, 24 % up on 2003 - were occupied ever since the system change. According to experts at least 1 % of the almost 4 million outdated dwellings, that is about 40,000 homes should be constructed each year to modernise Hungary's housing stock. The number of new dwelling construction permits declined somewhat (by 3 %) after an increase caused by the modification introduced in December 2003 to the housing loan system. The last quarter was dominated by a trend falling short of the average of the year: the number of dwellings put to use rose by 7.6 %, while the number of new dwelling construction permits issued decreased by 16 %.

According to the new building permits issued in the whole of 2005 the growth rate of the number of newly constructed homes is expected to diminish substantially and the number of dwellings put to use is expected to stagnate at the level recorded in 2004. In view of the construction period which takes an average of 5 quarters a modest decline in the first half is expected to be followed by a more notable reduction in the second half of this year.

Dwelling construction and construction permits
(trend cycle data)



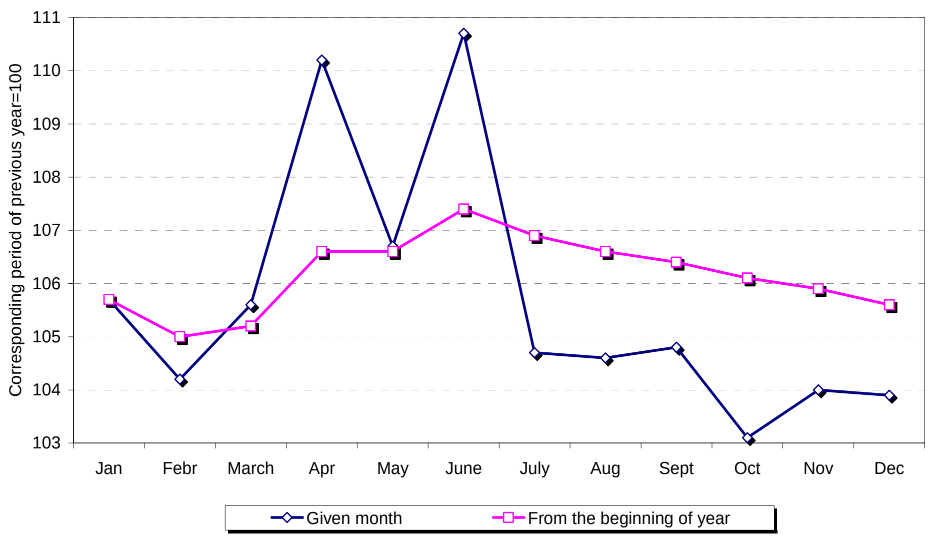
In comparison to year 2004 this year is expected to be characterised by more intensive motorway construction, stagnating dwelling construction and more or less unchanged business investment dynamic. The volume of investments in the national economy is expected to fall between 5 and 7 %. Negative risks continue to have to be faced owing to the uncertainties of the trends prevailing in Hungary's export markets and the high levels of the oil prices in the global market but the utilisation of the available EU capital transfer - of a volume expected to equal three times the volume of 2004 - may boost investment activity.

2.4 Retail trade, consumption

Slower growth of retail trade turnover

The dynamic of **retail trade turnover** slowed down somewhat in the fourth quarter. The growth of sales net of the motor vehicle and automotive fuel trade, adjusted for calendar effects, declined steadily with the exception of an increase in the second quarter, as a result of some one-off effects. During the whole of the year the retail turnover of food, beverages and tobacco products and that of non-food products increased by 2.8 % and 8.5 %, respectively.

Volume indices of total retail sales in 2004



Growing motor vehicle and component sales in changed structure

Although the number of new cars sold (208,000) was more or less equal to the number of cars sold a year before, the retail turnover of motor vehicles and components increased by 6.8 %. The increment resulted probably from the change of structure, the sale of used cars and from the turnover of motor bicycles and components. Automotive fuel sales exceeded the prior year's figure by a mere 3.2 %.

Retail trade turnover reached outstanding levels in the months of April and June in 2004. The first peak resulted form the rapid growth of car sales after the settlement of the uncertainties earlier in the year in relation to the introduction of the vehicle registration tax, the second stemmed from the upswing of the turnover of construction materials, furniture and household articles, which related to the development of residential construction.

Continued concentration of trade

The number of operating retail shops increased by 0.6 % in 2004, the average space of a unit expanded by 1.3 %. The expansion of facilities with large space (outlet centres, hypermarkets, specialised stores), continued, though at a slower rate than before.

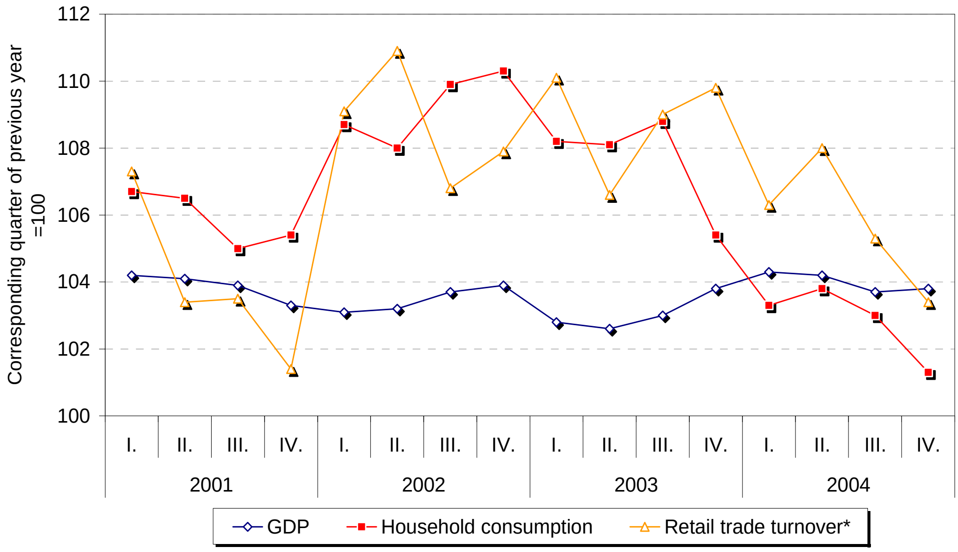
In January 2005 the volume of retail trade without vehicles and automotive fuel was up 3.2 %, the total volume of turnover was up 2.2 % while the price level of the later was 1.7 % up on the level registered in the first month of the previous year.

In line with the economic policy goals in year 2004 the dynamic of **household consumption** declined significantly in comparison to previous years: the volume of consumption increased by 9.3 % in 2002, 7.6 % in 2003 and by only 2.8 % in 2004. The slow-down was observed in 2004 within the year as well, for during the first half and the second half of the year consumption was up 3.5 % and 2.1 % up on the levels recorded during the corresponding periods of 2003.

Declining dynamic of consumption

The above deceleration was caused primarily by the slower outflow of incomes. While in 2003 the per capita real wage rose by 9.2 %, in 2004 it dropped by 1 %, as a consequence of a temporary acceleration of inflation, the restriction of wages in the budgetary sector and the alteration of the one-month extra remuneration system that is characteristically allocated in this sector. An increasing ratio of the household incomes is used for the servicing of credits taken out earlier. Another factor that contributed to the moderation of the dynamic of consumption was the growth of the propensity to save: besides the substantial residential construction the net cash saving rate also improved.

Quarterly growth rates



* Net of vehicles and fuel trade, adjusted for calendar effects

Household consumption is expected to increase by 3-3.5 % in 2005. There is an upward risk in the projection, however, it is not large enough to influence the equilibrium processes. Wage increases provided by some state owned companies (Volán transport companies and the Budapest Public Transport Company) in excess of the rate recommended by the National Interest Reconciliation Council and the continued demand for consumer loans as well as the significant decline of the rate of inflation may result in an increase of household consumption.

Dynamic of consumption may increase this year

2.5 Labour market

Number of employees increased

The **number** of full time **employees**[2] in the national economy increased by 0.8 % in 2004, according to institutional statistics published by the CSO. Different trends were observed in the various sectors: in the business sector - in line with the acceleration of economic growth - the number of employees increased by 1.5 %, while the number of people employed in the budgetary sector declined. Within the business sector the highest rates of staff increase were observed in engineering (3.1 %), in construction (4 %) and real estate related services (12.2 %). In the case of engineering this was explained by the dynamic expansion of exports while in the case of the other two sector the growth was caused by the outstanding performance of residential construction and sales.

Staff cut in the budgetary sector

The 1.3 % reduction of the headcount of the budgetary sector was a result of the economic policy endeavours aiming at downsizing the general government system. The largest staff cut (3.4 %) took place in the health sector. Besides the employees made redundant the reduction of the headcount of budgetary institutions may have been partly a result of the employment of manual labour as contractors (entrepreneurs), as is indicated by higher rate of staff reduction in the category of manual labour.

The number of employed persons dropped according to Labour Force Survey

In contrast to the above figures, according to a labour survey performed by the CSO the number of **employed persons**[3] dropped - for the first time since 1996 - by 0.6 % or 21,500 persons in 2004. The number of employed persons declined substantially in the manufacturing industry and in the national economy sector of agriculture, forestry and fisheries. The employment rate of the 15-64 age group - an internationally comparable figure - dropped from 57 % to 56.8 % while the activity rate dipped from 60.6 % to 60.5 % in 2004 (the employment rate of the eEU-25 was 63.7 %, its activity rate was 69.9 % in the third quarter of 2004).

The difference between the institutional statistics and the findings of the Labour Force Survey may be explained by a variety of factors besides the natural differences originating from statistical survey methods. Some of the difference is caused by the fact that in the trade and repairs sector - according to institutional statistics - the number of employees increased by a significant 8.4 % while according to the Labour Force Survey the number of employed persons declined by 1.3 % in the same sector. The growth of the number of employees according to the institutional statistics should be explained by concentration taking place in the sector: the employees of retail units, wound up or merged into others, were taken over by the larger enterprises, as a consequence of which the employees of smaller businesses - with less than 4 employees - were added to the statistics.

An assessment of the regions of Hungary reveals that the number of employed persons dropped primarily in the Central Trans-danubian region (by 20,700). In this region the number of unemployed people increased by 17.9 %, which is the

---

[2] Employees of businesses with at least 5 employees - observed by institutional statistics - and those of budgetary and social security organisations as well as the designated non-profit organisations

[3] According to the labour survey a employment is a person who carried out at least one hour of income generating work during the given week or one who had a job but was not working in it on a temporary basis (sick leave, holiday, maternity leave).

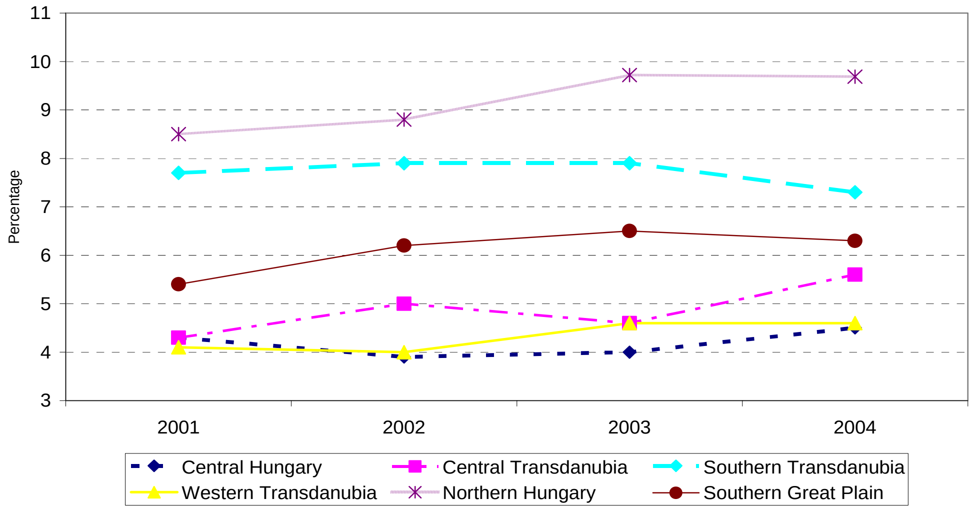
highest such figure among the regions of Hungary. This was primarily a result of the growth of the number of foreign employees, for the most part as a result of cross-border labour hiring.

Cross border hiring of labour on the increase

The growth of cross-border labour hiring made a visible contribution to the decline of unemployment in Slovakia and to that of employment in Hungary. According to data disclosed by the Slovak statistics office the number of unemployed people dropped in the areas (Nagyszombat, Nyitra) closest to the above region in Hungary by over 11,000 in 2004, while in the whole of Slovakia the total number of unemployed grew by 21,500. The number of Slovak guest-workers should be higher than the above since according to the Slovak Ministry of Labour, Social and Family affairs some 20,000 Slovakian citizens have been registered since 1 May as working in Hungary. Most of them are employed by larger companies.

The number of unemployed people increased by a significant 15 % even in Central Hungary. At the same time the number of employed persons also increased in the region, which may also indicate that in view of the better than average opportunities an increased number of people would like to return to the labour market.

Development of unemployment in a regional breakdown



Diminishing regional inequalities

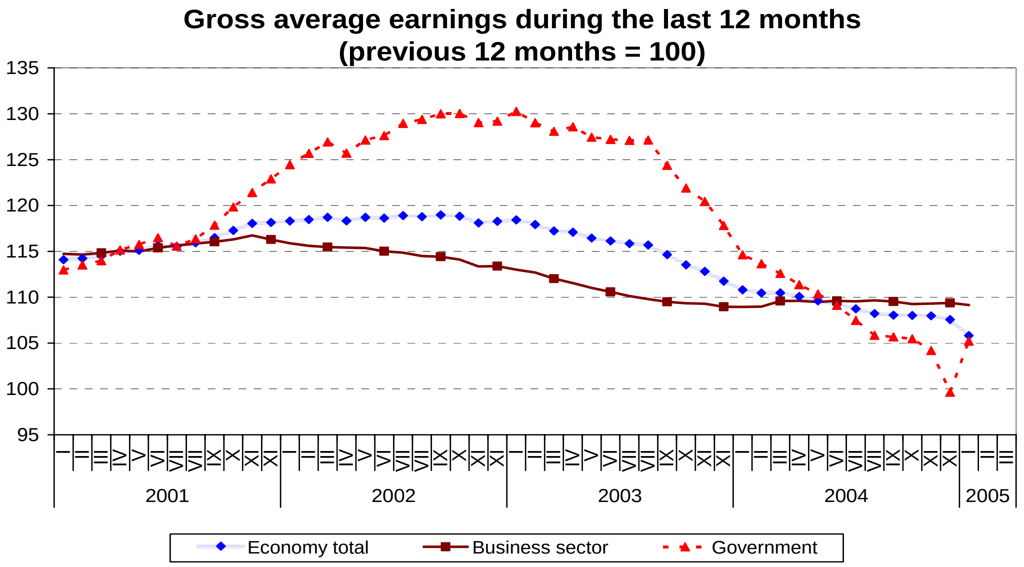
The overall **rate of unemployment** in Hungary rose in 2004 to 6.1 % from the 5.9 % recorded in 2003 (the unemployment rate of the EU-25 was 8.8 % in December 2004). Within this the largest increase in the unemployment rate was observed in the 15 to 24 year age group (from 12.6 % to 16.8 %), primarily as a result of the termination of the mandatory military service. The unfavourable process was balanced to some extent by the fact that the rate of unemployment declined somewhat in three regions where the rates are higher than average (in South Great Plain, Southern Transdanubia and Northern Hungary). The two processes resulted in a reduction of the regional inequalities.

In year 2005 the downsizing of the general government system continues in the budgetary sector, therefore the decline of the number of employees is expected to continue this year. As a consequence of a larger expected rate of staff increase in the business sector the level of employment in the national economy may grow by about 0.5 %. The upward trend is also confirmed by the data available on January: beside the 1.2 % drop of the total number of people employed in the budget sector a 0.6 % growth was recorded in the business sector and a 0.2 % increase was observed in the national economy as a whole. The increase of the headcount of the business sector in 2005 is also confirmed by some surveys: for example, the largest foreign-owned enterprises surveyed in January reported of expectations of staff increase for 2005[4].

The expansion of employment may be facilitated by the measures of the Government aiming to promote domestic labour hiring and part time employment. Such measures include for instance the modification of the regulation of the specific health contribution (EHO) enabling employers to pay amounts proportionate to the actual working hours, for part time employees. This may have been one of the factors contributing to a growth in January 2005 of part time employees after stagnation in 2004. One risk entailed by this measure is that instead of taking on new part time employees, employers re-categorise their existing employees as part time ones.

The increase of wages slowed down primarily owing to the budget sector

In 2004 **gross average earnings** and net average earnings increased by 6.1 and 5.7 %, respectively. In a sectoral breakdown however, the growth of wages shows a variety of different trends: the annual increase of the gross average wage in the budget sector - partly owing to the change of the system of the one-month additional salary - fell short of 1 % while the 9.3 % increase of gross average earnings in the business sector exceeded the 8 % upper limit of the national recommendation.



Real wages dipped

What with a 6.8 % inflation rate real earnings dropped by 1 percentage point in

[4] Wargo Közgazdasági Intézet: Expectations of the largest manufacturing firms, 2005 1st half

2004. This is a combined effect of a 1.1 % growth of real wages in the business sector and a 5 % decline of the same in the budgetary sector, essentially as a result of the above-mentioned modification of the rule on the one-month additional salary.

by 1 % in 2004

Box 2.2

Modification of the regulation on the one-month additional salary

The regulation governing the disbursement of the one-month additional salary was modified in February 2004. According to the amendment the employees of the public sector receive this one-month salary in the month of January from 2005, in a standardised scheme. This standardisation involved some 63 % of the employees - some 510,000 people - of the budgetary sector. Some 40 % of public employees and some 30 % of civil servants (fire-fighters, police), already received this allowance in January. This modification to the rule caused a distortion in comparison to 2003, since the one month additional salary for some 510,000 persons was booked in January 2005 instead of December 2004 (together with the taxes and contributions this amount is estimated to equal some HUF 85 billion). In order to render processes comparable data should be adjusted to remove this distortion. According to the adjusted data - based on our calculations - an annual 4 % gross and net wage increase took place in the budget sector. In the budget sector this results in a 2.5 % real wage drop instead of 5 % while on the level of the national economy as a whole, the level of real wages did not change from 2003 to 2004, instead of the originally calculated 1 percentage point decline.

Higher than average wage increase in the manufacturing industry

In a breakdown by sectors a higher than average (10 %) gross average earnings increase is observed in industry and in its dominant branch (manufacturing industry). An approx. 2.5 percentage point staff reduction took place in this sector. The reason for this was the 9-10 % decrease of the number of employees in the areas with lower productivity ratios in manufacturing industry, particularly those paying minimum wages (textile, leather, food, beverage and tobacco manufacturing). These branches are becoming less and less competitive in the international markets, consequently, they are expected to continue laying off workforce.

Employees of the above mentioned branches are partly employed in engineering - the main engine of manufacturing industry turning out exportable goods - where the number of employees increased in 2004 by 3.1 %. The reason for the lower rate of headcount growth than in other areas of the business sector probably lies in the structure of the labour market. As a result of technical development, enterprises seek for more highly qualified employees, who are - according to a significant percentage of the enterprises concerned - on a short supply in Hungary[5].

Based on the favourable trends in construction the number of employees increased by 6.4 % in this sector, while the gross average earnings rose at a rate below the average: by 4 %. One reason for this may be the growth of the employment of less expensive guest labour.

Across the national economy gross wages and net wages are expected to rise in 2005 by 6-7 % and 8-9 %, respectively. The approx. 2 percentage point higher increase of net wages than gross wages is explained by the effect of the

[5] According to a survey carried out by Foglalkoztatási Hivatal (Employment Office) in September 2004

amendment to the personal income tax act. Owing to the elimination of the medium rate of the three-tier tax system in effect in 2004 the tax burden primarily of those who used to pay their taxes in the middle range and above, will be reduced. Owing to this change and the lower than expected rate of inflation a 4-5 % real wage increase is expected for this year.

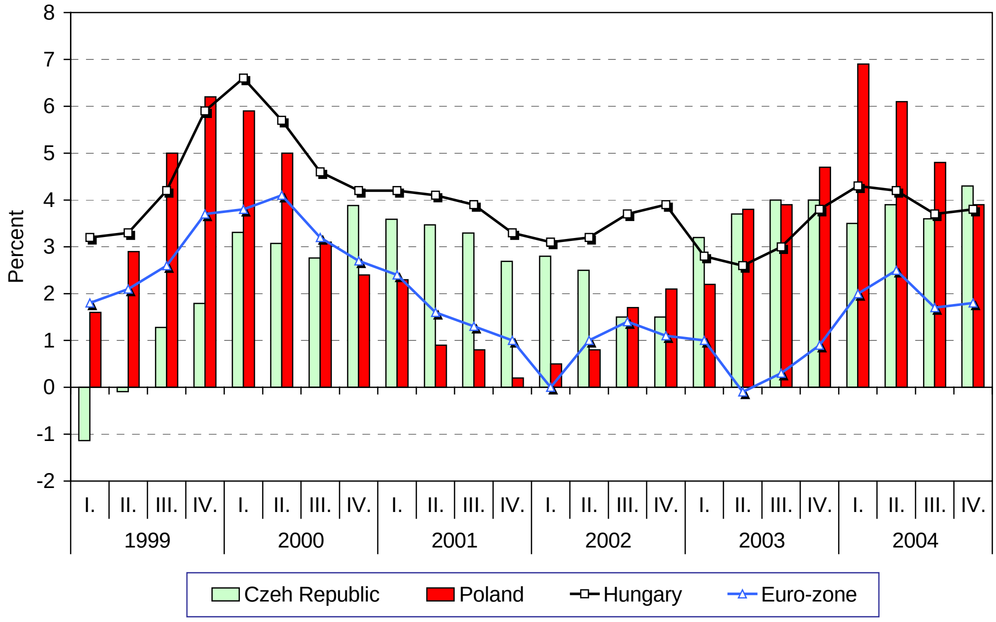
The above wage increase forecast is also supported by data on January 2005. The regular monthly gross average earnings of full time employees increased by 6.3 % in the budgetary sector and by 7.2 % in the business sector. This is higher than the 6 % recommendation of the Interest Reconciliation Council primarily as a result of the sectoral agreements concluded so far (Volán /public transit company/, the power sector, transport and postal branches), as a consequence of which the growth rate may exceed 6 % over the year. This may be compensated for by the fact that wage increases later in the year may be determined in view of the lower than expected inflationary expectations as well. In the budgetary sector an 8 % rise of gross wages is expected, owing to the amendment to the regulation on the one-month additional salary.

2.6 Growth

Vigorous growth

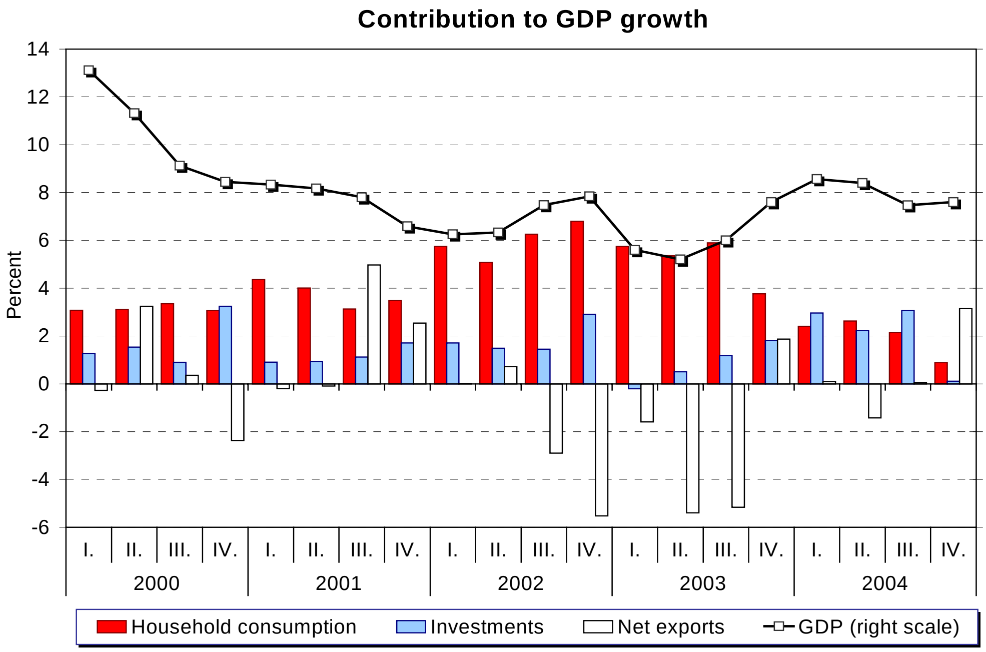
The economy of Hungary responded well to the improvement of the external economic environment in 2004: the **gross domestic product** increased by 4 % in the whole of the year and by 3.8 % in the last quarter. The last year when the economy of Hungary generated a growth of 4 % was year 2000. This rate ranks favourably among the Member States of the European Union. Hungary has delivered the most balanced and highest GDP growth rates as an average of the past seven years, among the Visegrád countries: while between 1997 and 2004 Hungary's GDP increased by an annual average of 4.1 %, the corresponding ratios of the Czech Republic, Slovakia and Poland were 1.9 %, 3.7 % and 3.9 %.

The quarterly GDP growth rate in Euro-zone, the Czech Republic, Poland and Hungary



Growth has been produced in an economically healthy structure, driven by outstanding export and investment performance, unlike the earlier consumption-oriented growth structure.

Healthy economic structure

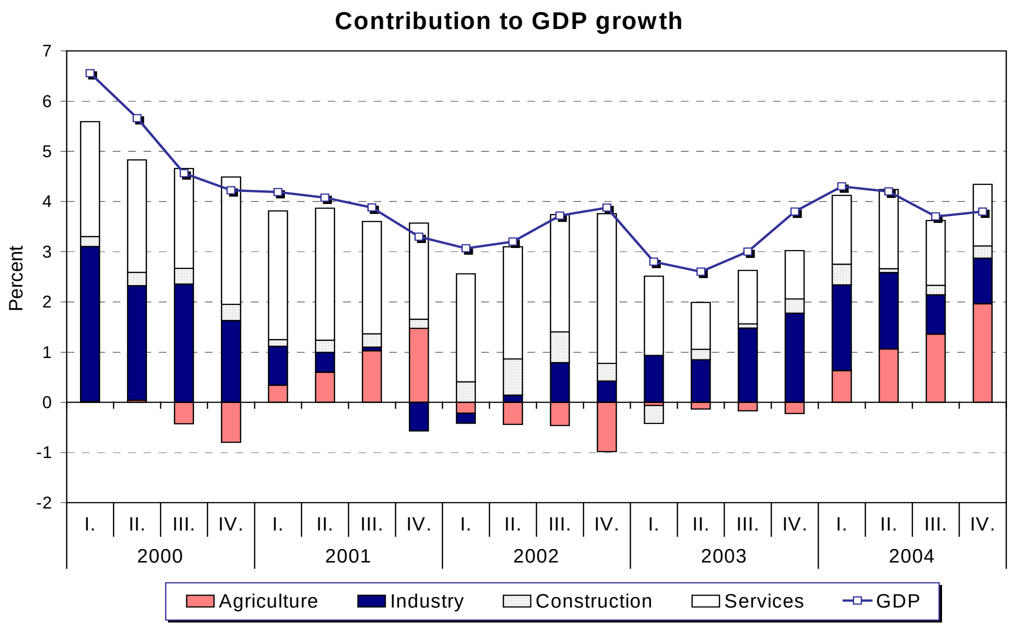


On the use side the growth of household consumption gradually slowed down from quarter to quarter - ending up at a growth rate of 2.8 % over the whole of the year. Such decline of the dynamic of consumption was also confirmed by the modest drop of real earnings and the data of retail turnover. Each sector made a substantial contribution to the dynamic (8.3 %) growth of gross fixed capital formation. Turnover in the foreign trade of goods and services grew steadily throughout 2004. Export expanded by a substantial 15.7 %, import increased by a significantly lower 14.0 %. Quite favourably, the high rate of growth of imports resulted from the importation of productive goods rather than products for consumption. Net export made a positive (0.5 %) contribution to economic growth.

Decelerating growth of consumption, dynamic investment and export performance

In the structure of the GDP production the value added by the production of sectors increased by 8.5 % while the value added by the services increased by 2.5 % over the figures recorded in 2003. Within the sectors producing goods growth was pulled by the outstanding performance of agriculture (36%). Industry and construction equally expanded by some 5 % while a modest - 2.5 % - increase of GDP resulting from services was partly a consequence of the staff reduction in the sectors relating to the general government system (education, public administration, health, public services).

Substantial contribution by agriculture



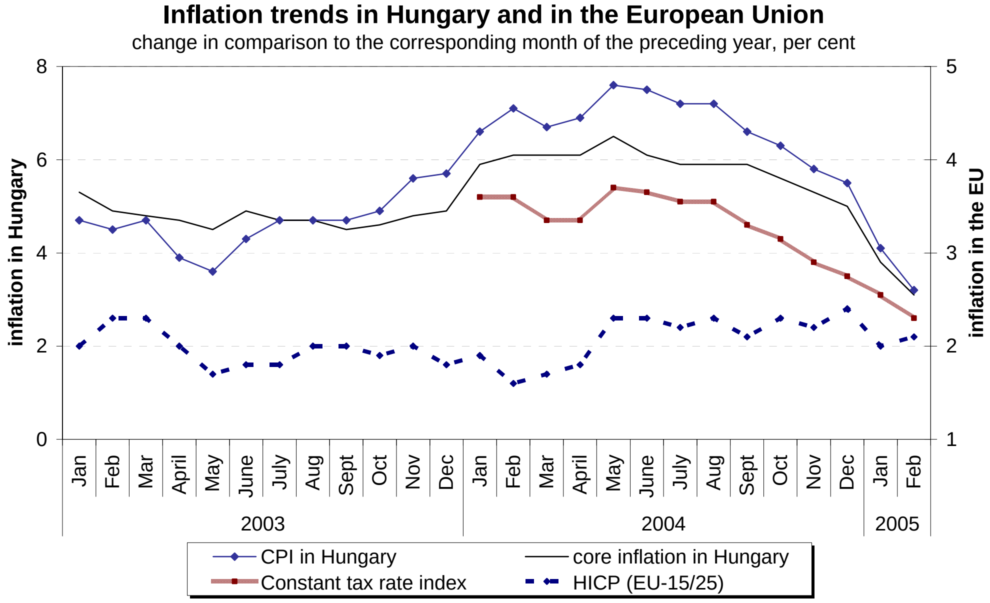
As a consequence of a slight deterioration of the external growth conditions and the high basis of 2004, the growth of the economy of Hungary is expected to decline somewhat in 2005. Further uncertainty stems in 2005 from the question whether agriculture will manage to repeat its outstanding performance recorded last year. In view of the above, a 3.5 - 4.0 % increase of GDP is expected for 2005.

A 3.5 - 4.0 % increase of GDP is expected for 2005

3. Inflation

The economy of Hungary showed a high degree of adaptability in **2004** when the price index calculated without the effects of the changes to the taxation rules declined - i.e. the long term decline of inflation was maintained - despite the soaring international oil and raw material prices, the uncertainties before the EU accession of Hungary and the substantial modifications to the taxation rules and regulatory conditions. This was partly a result of the improvement of the credibility of Hungary's economic policy, as a result of which the temporary price increasing effect of the indirect taxes did not influence the inflationary expectations.

Long term decline of inflation maintained in 2004



From among the factors influencing inflation mention should be made of the negative effect of the fiscal adjustment between 2002 and 2004 on consumption along with the decline of the growth of household consumption to a sustainable level - which decelerated significantly from the last quarter of 2003 - in parallel with the slow-down of the growth of real wages. An even more salient process was the slow-down of final consumption in parallel with the decline of public consumption. By the end of the year the rate of economic growth diminished somewhat and the reduction of inflation was also facilitated by the economic environment. Owing to the time it takes for effects to materialise these factors had only a partial effect on the inflationary processes in the second half of 2004 (perceived primarily in the reduced inflation of the prices of services) but their effects are more pronounced in 2005.

The increase of prices was slowed down by demand side factors including a fiscal adjustment

The adaptation of the supply side was ensured by the price moderating effects of the growth of the output of manufacturing, import competition, the strong HUF and the steady expansion of the retail supply. The producer and consumer prices of industrial products and food products are increasingly closely aligned to the EU or at least to the regional price levels. This imposes an important requirement on production and trade in competition with imports in terms of efficiency.

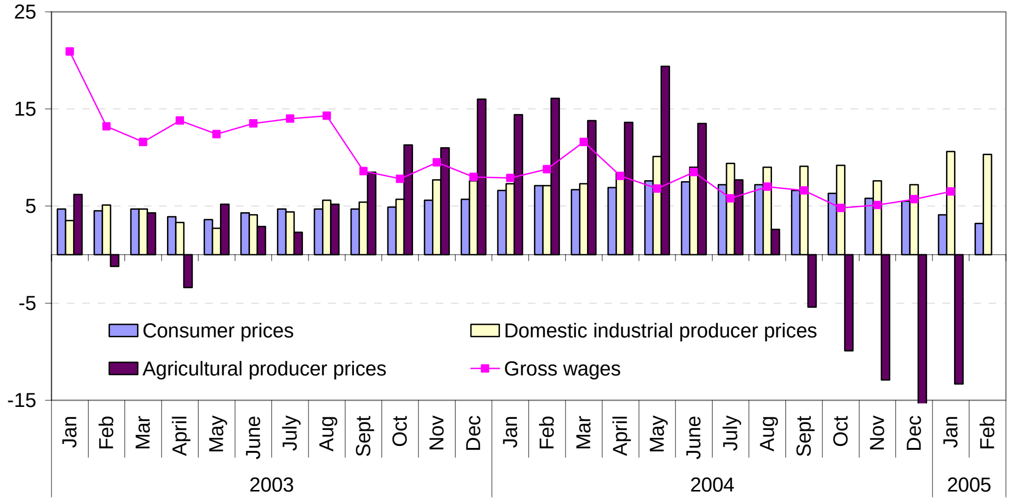
The rate of the HUF kept steadily rising against the EUR (and against the USD) during the year (except for the second quarter). Besides the general weakening of the dollar this process dampened the effects of the international energy price increase and played a role in the decline of the inflation of manufactured products. In the second half labour market scarcities eased somewhat, the growth of wages slowed down during the year, which had an impact on the demand side as well.

Fuel prices were characterised by a high degree of volatility during the year as a result of the higher than expected level and the fluctuations of international oil prices. Besides the energy prices the price increasing effect of the substantial

Strong competition restricts passing costs on to growth of final demand for raw materials and semi-finished goods appeared in both the domestic and the European industrial producer prices. However, the price restricting effects of the intensive competition in the global market did not disappear and this prevented the development of an upward trend in inflation in the market of manufactured consumer goods. As a result of the high crop yields during 2004 - even including the rising prices of livestock for slaughter - the agriculture sector contributed to the diminishing of inflation.

consumers through prices

Development of consumer and producer prices, gross wages
change in comparison to the same month of the preceding year, per cent



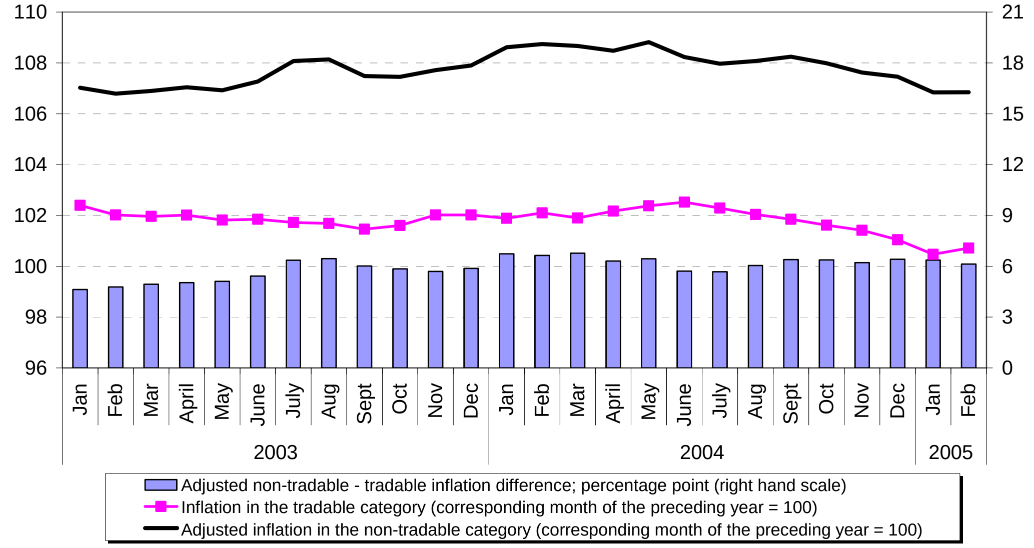
*: Having eliminated the distorting effect of the altered regime of the payment of the one month extra allowance in the public sector, from the figures on December 2004 and January 2005

The inflation of the (so-called tradable) group of products originating from imports or directly competing with imports[6] remained below 2 % in 2004, after a steady decline in recent years. At the same time the rate of inflation of market services (the so-called non-tradable category) was at an average of 8%[7].

[6] Including clothing products, durable consumer goods and industrial products without drugs and motor vehicle fuels.
[7] From the *Services* category as applied by the CSO, without services subject to administered pricing and the line *Owner occupied dwellings* but including the line *Meals at restaurants, cantines.*.

The average price increase hides marked differences between products and services

Tradable and non-tradable inflation in Hungary
Adjusted for the statistically distorting effect of the elimination of the fee payable for the use of television sets



As a consequence of the strengthening of the HUF and the intensification of international and domestic competition inflation declined steadily in the category of goods while the acceleration of the growth of wages in 2002-2003 and the increase of household income and consumption had an inflationary effect both on the cost and the demand side. The increase of the share of services within consumption also contributed to this effect. At the same time, the rising of the prices of services started to slow down from the autumn of 2004 as a result of the contraction of demand and the slow-down of the growth of wages.

The impacts of tax measures introduced by the Government were quite substantial in 2004. The raising of the preferential VAT rate accounted for some 2 percentage points both in the year-on-year inflation rate in December and in the annual average rate. The effect of the increasing of the excise tax was moderate in the case of alcoholic beverages and it materialised in early 2004, while the larger tax raise on tobacco products had its first effects on the processes in the second quarter. The introduction of the registration tax lead to an increase of the prices of new cars and to a decline of the overall annual turnover.

In the case of services whose prices are regulated by the state or by local governments, prices were set in line with inflation in some areas, based on the incorporation of prices, in other cases the maintenance of the services, the saving of budgetary funds and the strengthening of the cost based nature of the tariff structure demanded higher price increases (such as for instance in the case of water supplies and sewerage services or public transport). The transfer of electricity to the category of products subject to the regular VAT rate resulted in an increase of the consumer prices.

Inflation expected to decline substantially in 2005

The current projections are indicative of an annual average of 3.5-4.0 % inflation **for 2005**. The expected annual average which is even lower than the rate specified earlier in the convergence programme resulted from the economic processes which emerged in the latest months of 2004 and the early part of 2005, driving a faster than expected decline of inflation. Within the year, primarily for reasons relating to statistics, the inflation rate is at its lowest during the spring months.

From the aspect of the inflationary processes the dominant factors on the demand side include a faster growth of real wages than was recorded last year, a modest expansion of household consumption and a smaller decline of public consumption. The demand side effect of the reduction of the expenditures of the general government system planned for 2005 - in addition to the previous reduction - will materialise in 2005.

On the supply and the cost side the deceleration of the growth rate of global demand in the market of raw materials and intermediary products is indicative of an expected consolidation and decline of prices in 2005. The current high levels of oil prices are expected to be followed by a decline of prices. International and domestic competition in production and trade continues to be intensive, contributing to a more favourable inflationary environment through the restriction of producer prices. The economy of Hungary is expected to operate in an European environment characterised by a balanced development of prices. The development of the exchange rate of the HUF is also expected to be a balanced process. No major change is expected in the USD/EUR rate. The growth of gross wages will continue to decelerate.

The price moderating effect of the improvement of efficiency resulting from the increasing intensity of competition will continue to reduce inflation in the market of consumer goods and clothing products, keeping it below 2 % meaning practical price stability. This applies to a growing range of processed foodstuffs as well. The decelerating expansion of household consumption and the slow-down of the increase of wages on the demand and cost side along with the easing of the scarcities in the labour market forecast a decline of the rate of growth of services available in the market.

In the areas subject to price regulation an about average price increase is expected in the governmental areas. In the local governmental area prices are expected to increase at rates somewhat in excess of the average in order to maintain the technical and economic operability of local public services.

In respect of the expected inflationary processes only a coincidence of a change of a number of factors in the same direction could entail any material uncertainty. Such a coincidence would be an overlapping and equally inflation driving (or reducing) change of the exchange rate of the HUF, of international price trends and the USD/EUR cross exchange rate.

4. Income and financial developments

4.1 General government

ESA deficit at 4.5

Based on the data contained in the Notification produced for the European

% of GDP in 2004,...

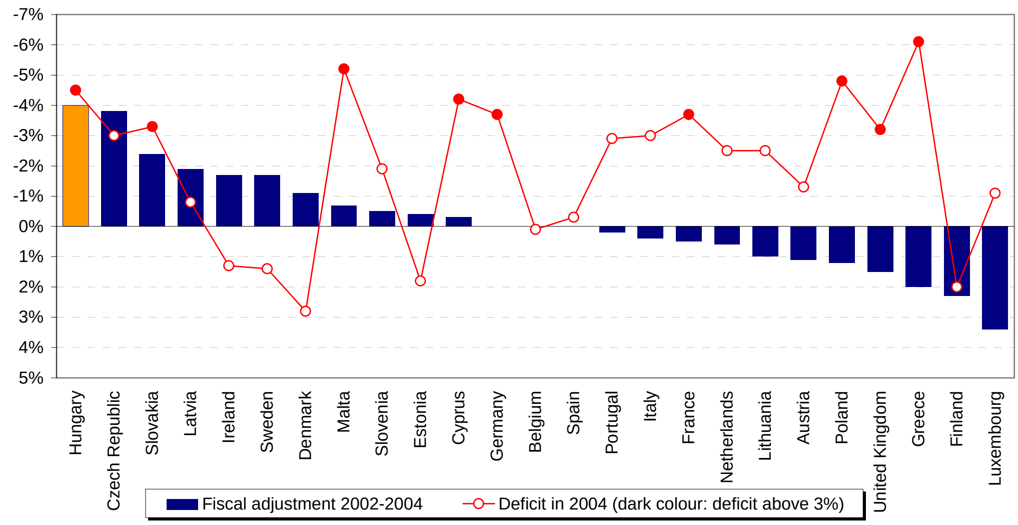
Union the ESA95 **deficit of the general government** - including the mandatory private pension funds [8] – equalled 4.5 % of GDP (or HUF 901 billion) in 2004. Thus the deficit adjusted for the effect of the pension reform - which is suitable for international comparison in this way - corresponds to the projection disclosed by the Ministry of Finance in early December. (Together with the effect of the pension reform the deficit equalled 5.4 % of GDP).

The general government deficit exceeded the 3 % reference value in nine out of the 25 Member States of the European Union. In these nine countries the deficit varied between 6.1 % (Greece) and 3.2 % of GDP (United Kingdom). The Hungarian ratio of 4.5 % is near the middle of this range..

...the adjustment was one of the largest such manoeuvres in the EU25

The accrual based data give a clear indication of the significant fiscal adjustment implemented in Hungary. In comparison to the figure recorded in 2003 the ESA deficit dropped by 1.7 percentage point (down 4 percentage points from 2002). In terms of the size of adjustment Hungary ranks fourth between 2003 and 2004 and first between 2002 and 2004, among the 25 Member States of the European Union.

Fiscal adjustment in EU Member States between 2002 and 2004*



*Source: Eurostat, March 2005

Cash based deficit below expected level

The cash based deficit of the general government equalled 6.4 % (HUF 1,302 billion) in 2004. According to preliminary cash based data the balance of both the central government and local governments ended up at levels more favourable than originally expected. The deficit of the central government (including central budget, social security funds and the extra budgetary funds) amounted to HUF 1,285 billion (or 6.3 % of GDP), some HUF 50 billion below

[8] In comparison to the Convergence Programme of May an important methodology change was introduced in respect of the presentation of the general government data. In view of the interim period provided for in the communication of 23 September 2004 of the Eurostat (Eurostat News Release 117/2004), in the updated Convergence Programme of December the mandatory pension funds operating on a fully-funded basis, were stated as part of the general government. The Notification produced in March 2005 for the European Union also presented the deficit and debt of the general government according to this rule. The balance of the revenues and expenditures of funds is also part of the deficit and in the calculation of the public debt the portfolio of government securities held by private pension funds is consolidated.

the projection which had to be raised in September. The improved balance resulted form the HUF 90 billion more favourable position of the central budget. At the same time the deficit of the social security funds exceeded the expected level by HUF 40 billion.

Effective restriction of spending

The interim measures aimed at restricting and controlling expenditures (freezing of appropriations, restriction of the utilisation of residual appropriations from previous years) proved to be successful. The net expenditure of the central budgetary institutions (net of expenditures covered from their own revenues) fell short of the projected level. Without the expenditures of the budgetary institutions and the chapter-managed appropriations from their own revenues and EU supports the primary expenditures of the central budget developed in line with the projection associated with the deficit target announced in September and the total spending fell short of the expected level by 0.1 %. The modest (0.2 %) extra expenditure of the social security funds related primarily to pensions and medicines. From among the large items of the revenue side smaller than expected amounts were collected from personal income tax and social security contributions. A favourable change in the structure of growth is confirmed by the fact that the budget received higher than planned revenue from corporate income tax payments.

The accrual based data are more suitable for forming a realistic view of the fiscal position than are cash based ratios. One-off measures and the changes of the regulatory system may remove cash flows even by a substantial degree from the revenues/expenditures associated to the economic events of the given year but such distortions are eliminated by an accrual based approach. The difference between the cash based and the ESA deficit includes, besides the difference in respect of the group of organisations involved (e.g. according to ESA rules some non-profit and other organisations such as the State Privatisation and Holding Company /ÁPV Rt./ and National Debt Management Company /NA Rt./ etc. are also parts of the general government) and other adjustments, the accrual based adjustment of payroll expenditures, interests and the tax and contribution revenues.

In the Notification submitted in March to the European Union the methodology of the recording of VAT was altered (see Box 4.1). The goal of the change was to ensure that the accrual based data more fully comply with the requirement that - regardless of the date of performance of cash movements - only the items actually pertaining to the year concerned be taken into account. The revision was carried out with a retroactive effect as well, which also had an effect on the 2003 ESA deficit. The accrual based deficit of the general government amounted to 6.2 % of GDP in 2003 even together with the private pension funds. The actual extent of the adjustment effected in 2004 is revealed by the revised data.

Box 4.1

Accrual based adjustment of VAT revenues

The accrual based establishment of tax revenues may be carried out in accordance with the one of two approved methods according to the rules applied by the Union:

- based on data contained in tax returns, adjusted by the application of a co-efficient showing the ratio of taxes specified in tax returns but never paid,

- based on the method of adjustment of actual cash-based receipts.

Hungarian data are worked out according to the latter method. In previous calculations the domestic VAT payments in January (on sales effected in December of the preceding year) and the VAT returns in January and February (based on returns submitted in December and January on turnover in November and December) were booked on the preceding year. This method was suitable up to 2002, to estimate accrual based data.

Since mid-2003 however the previous practice of effecting VAT refunds was altered and instead of *within* the 30 or 45 day period prescribed by law, refunds were paid *on* the last day of the period for refund. As a consequence of the 45 day deadline the VAT whose refund was claimed in the returns submitted in January 2004, was actually refunded in the first days of March.

The one month ‘shift’ of payments and the two month ‘shift’ of refunds was not suitable for the elimination of the effects of the change of the refund system or of the intensified inspections in the second half of 2004 on the refunds. The basic principle of the accrual based correction is however, that accrual based data may not be distorted by one-off measures or by any change of rules on cash transactions.

In addition to the booking of payments in January to the December accounts, the new methodology now applied - a refinement of cash based adjustment - attaches all refunds to the year to which they actually relate. (I.e. the ones of the refunds effected in March 2003 that relate to 2003 are attached to 2003 while those of this year’s refunds that relate to last year are booked to the accounts of 2004.)

Deficit at 3.6 % in 2005, though...

According to the year 2005 budget the ESA95 deficit of the general government - including private pension funds - may be at 3.6 % of GDP. In the wake of the vigorous improvement in the previous two years the process of fiscal adjustment will be continued this year, though it will not be as severe as before. The balance is planned to be improved via reduced spending, rather than by increasing revenues.

..the deficit will increase faster at the beginning of the year

The 3.6 % ESA95 deficit will entail a cash based deficit of HUF 1,022 billion (4.6 % of GDP) at the level of the central government. Since expenditures are not evenly spread over the year, the deficit will increase somewhat faster during the first months of the year. At the beginning of the year the expenditures are increased by the payment of the one month extra remuneration for civil servants and public servants, the advance to be transferred in order to finance health services and pharmaceutical subsidies, the settlement of invoices of motorway constructions, the instalment of the repayment for the Gripen fighter planes, the disbursement of the national subsidy supplementing the EU supports in the case of the agricultural supports etc.

Guarantee rules to manage risks on the expenditure...

In order to meet the deficit target and to properly manage the relevant risks a number of guarantee rules have been incorporated in the budget and the general government act that are tighter than the ones applied before. In previous years the utilisation of the appropriations of budgetary institutions left over from preceding years regularly carried a risk of increasing the expenditures. According to the budget act on 2005 the residual funds cannot fall below the amount booked at the end of 2004, i.e. the utilisation of residual appropriations may not increase the deficit.

...and the revenue side

In order to manage any risk on the revenue side in addition to the general reserve and specific provisions the budget act prescribed the generation of an extraordinary general government reserve. This reserve may be used only if the processes during the year show that revenues are received as expected. To ensure further risk mitigation and in view of the recommendation addressed to Hungary in the course of the excessive deficit procedure (see box 4.2), in March the Government reduced the appropriations that are exempt from the obligation to generate reserves, and set the rate of the general government reserve at 0.8 % of GDP.

Box 4.2

Hungary and the excessive deficit procedure

Pursuant to Community legislation in effect in Hungary - as well - since the date of the EU accession, Member States are obliged to make efforts to ensure sustainability of the position of public finances, they have to avoid and/or terminate excessive deficits of the general government. The existence of excessive deficit and the measures aimed at eliminating it are established through a process called excessive deficit procedure (EDP). According to a decision taken by the council of ministers of finance (Ecofin) at present there are ten countries - six new Member States (Hungary, Czech Republic, Slovakia, Poland, Malta and Cyprus) and four old Member States (Greece, Germany, France and the Netherlands) - are subject to the excessive deficit procedure.

According to the target formulated in the first convergence programme submitted in May 2004 Hungary intends to reduce the deficit (not adjusted for the effect of the pension reform) to below the 3 % reference level by 2008. The existence of excessive deficit was established by Ecofin on the basis of the year 2003 deficit and for the elimination of the excessive deficit the same forum approved the multi-year fiscal adjustment path outlined in the convergence programme. At the same time a recommendation was made for Hungary according to which the 2004 deficit target should be met and the year 2005 budget should be planned in view of the deficit planned for 2005.

Since under the tight monetary conditions any increased fiscal austerity in addition to what has already been implemented would have jeopardised the growing economic uplift of the observed healthy structure, in September 2004 the Government increased the forecast of the deficit expected for 2004, by 0.6 percentage point. At the same time it was announced that the target set for 2008 will be accomplished through an adjustment that will be somewhat more substantial than as outlined in the May programme. The updated convergence programme submitted in December was drawn up on the basis of the new circumstances.

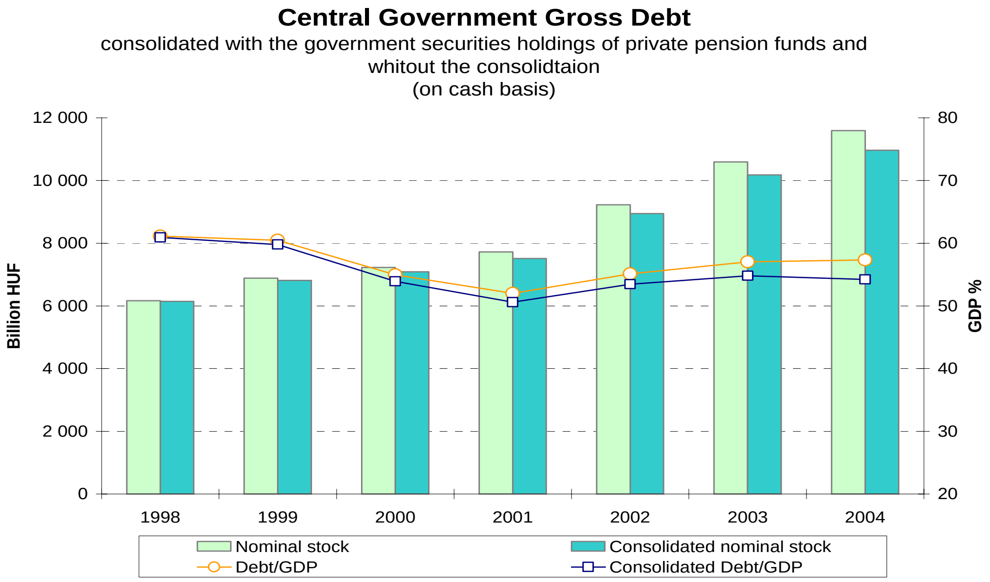
Though the fact that an adjustment took place in 2004 was recognised by Ecofin, the forum established that Hungary failed to comply with the recommendations - owing to the failure to meet the targets specified in May - as a consequence of which the excessive deficit procedure progressed to the next phase. The targets specified in the updated convergence programme were approved by Ecofin and an additional measure (increasing of the budget reserve) was recommended to mitigate risks..

* * *

The approach of taking the effect of the pension reform into account in the appraisal of the general government deficit (over a five year period from 2005, to an extent gradually reduced year by year) was approved by Ecofin and later by the European Council on 22-23 March, as part of the reform of the Stability and Growth Pact.

The **general government debt** equalled 57.6 %[9] of GDP on 31 December 2004. The HUF debt declined within the total public debt (from the 75.6 % of 2003 to 74.3 %).

[9] See footnote No. 8. According to the previous methodology the general government debt to GDP ratio would equal 60.7 % in 2004.

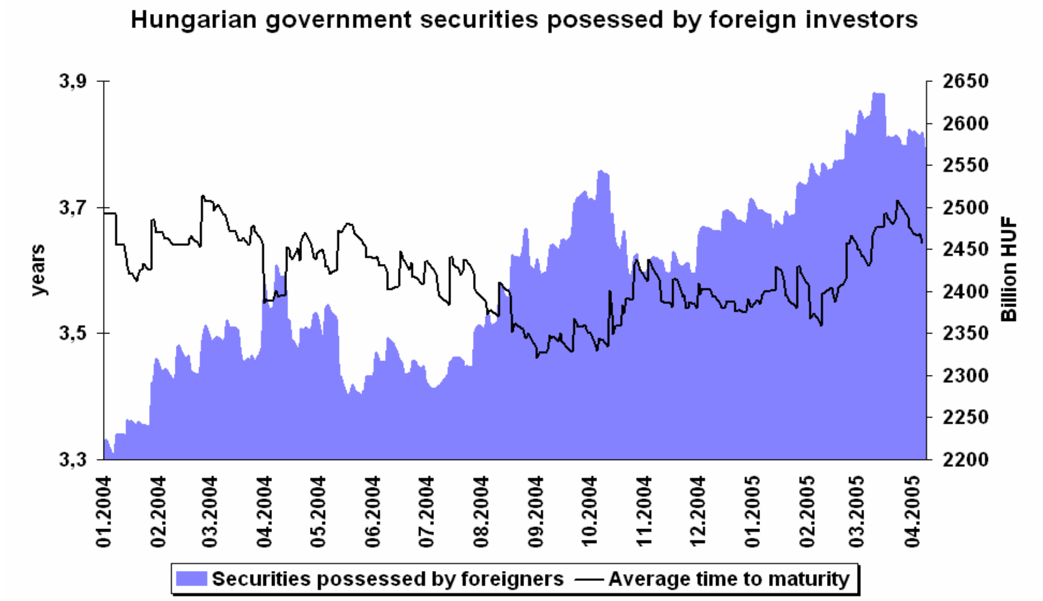


Slight increase of debt ratio in 2004

The gross debt of the central government increased in 2004 by HUF 1,004 billion to HUF 11,592 billion. The deficit of the treasury sector that had to be financed made up HUF 1,252 billion of the increment, which was increased by HUF 32 billion of the debts assumed which did not require separate financing, along with the HUF 65 billion resulting from pre-financing of direct EU payments and the increase of the balance on the Single Treasury Account. Besides the items resulting in a total of 1,350 billion growth of debt the increase of the debt was reduced by HUF 346 billion by the extraordinary revenues from privatisation and the strong HUF - through the re-valuation of the debt denominated in foreign currencies. Though the debt stock increased at a rate falling short of the expectation and economic growth met the expectations, yet as a result of the lower than projected nominal GDP the cash based debt ratio (calculated without the private pension funds) increased slightly.

Improving conditions, meeting strategic goals in financing

The conditions of financing improved steadily in 2004 and yields started to definitely decline from the high level observed in late 2003. The budget deficit was financed in accordance with the strategic goals of debt management. The most important such strategic goal was to increase the role played by FX issuances, to alleviate tensions in the HUF market. As a consequence - despite the fluctuations of the financing requirements - financing remained undisturbed throughout the period, without any liquidity problems. During two thirds of the year over-financing was achieved, ensuring an appropriate balance on the Single Treasury Account. The increased role played by foreign exchange debt enabled the decline of yields in the HUF market and the implementation of financing in accordance with the debt management strategy. In order to improve the structure of the HUF debt the increasing of the share of fixed interest rate bearing government securities denominated in HUF was continued, along with the extension of the maturity of the HUF portfolio. At the end of December 67,3% of the government securities denominated in HUF were fixed, 32.7 % of them variable interest bearing papers, the average term to maturity increased to 3.03 years.



The foreigners' share in the financing of the debt increased: in contrast to the 45 % of 2003 at the end of 2004 a 47.4 % of the total government debt was held by foreigners. The portfolio of government securities possessed by foreign investors increased by HUF 287 billion to HUF 2,510 billion during 2004 and the change of the portfolio closely followed the movements of the yield rates. The foreign exchange debt increased to the equivalent of HUF 2,983.5 billion, reaching 25.7 % of the total debt stock in year 2004.

Continued increase of foreign participation in financing

Composition of the central government gross debt

HUF billion	2003		2004		Change		2005		Change	
	close	%	close	%	HUF bn	%	February	%	HUF bn	%
FX	***2 579,0***	***24,4%***	***2 983,6***	***25,7%***	***404,6***	***15,7%***	***3 379,7***	***27,7%***	***396,2***	***13,3%***
Government securities	1 494,9	14,1%	2 066,8	17,8%	571,9	38,3%	2 555,6	21,0%	488,8	23,7%
Loan (marketable)	617,6	5,8%	561,1	4,8%	-56,5	-9,1%	547,1	4,5%	-14,1	-2,5%
NBH loan	466,5	4,4%	355,7	3,1%	-110,8	-23,8%	277,1	2,3%	-78,6	-22,1%
HUF	***8 009,1***	***75,6%***	***8 608,8***	***74,3%***	***599,7***	***7,5%***	***8 801,1***	***72,3%***	***192,2***	***2,2%***
Government securities	7 891,2	74,5%	8 604,1	74,2%	712,9	9,0%	8 797,7	72,2%	193,5	2,2%
Loan (marketable)	117,9	1,1%	4,7	0,0%	-113,2	-96,0%	3,4	0,0%	-1,3	-27,7%
Total	***10 588,1***	***100,0%***	***11 592,4***	***100,0%***	***1 004,3***	***9,5%***	***12 180,8***	***100,0%***	***588,4***	***5,1%***

The framework of the financing of the 2005 budget is determined by a new debt management strategy. Its two key features are the enabling of an increase of the share of FX debt along with granting preference to variable interest bearing instruments with shorter repricing periods, if market processes support the lower costs of such instruments.

In 2005 a new debt management strategy …

In 2005 the cash based deficit of the organisations comprised in the scope of the Treasury declines substantially both as a ratio and in nominal terms in comparison to the 2004 figure. In contrast to 2004 the balance of the extraordinary financing items (the reserve replenishment requirement of the NBH, pre-financing of the agricultural supports financed from the EU EMOGA Guarantee Fund, privatisation revenues) will increase the financing needs. On the whole however, the total net financing requirement will still be below the

…diminishing budget deficit …

level registered in 2004. In 2005 the gross amount of debt repayments is expected to exceed the redemption effected in 2004, by almost 10 %. Owing to the reduction of the deficit of the organisations in the Treasury scope however, this growing redemption requirement is not expected to lead to tensions in financing. In 2005 the HUF market will continue to be the key financing market for the state of which government bonds, Treasury bills and government securities held by private individuals make up 25 %, 64 % and 11 %, respectively. No HUF loan will be taken out in 2005 either.

In early 2005 financing has been in line with the plans, to a large extent owing to the continued decline of yields.

…improving market conditions …

The reduction of debt and budget deficit relative to GDP is an essential goal of the current economic policy. In year 2005 a lower deficit, the new debt management strategy and the lower interest rate level ensure the reduction of the debt ratio which is expected to stand at 55.5 % by the end of the year, on an accrual basis.

…combine to reduce - as expected - the debt ratio

From the aspect of the debt the exchange rate, interest rate and the primary balance developments may constitute risk factors.

- *Exchange rate:* the development of the HUF rate may increase or reduce the debt stock via revaluation, through the foreign exchange debt accounting for more than a quarter of the debt stock (an exchange rate change of one HUF may modify the debt stock in 2005 by HUF 12-15 billion in 2005.)
- *Interest rate:* if yields depart from the current projection, the interest expenditure will change. In the case of a yield curve shift of one percentage point the interest expenditures will change by HUF 20-21 billion or by HUF 30-35 billion depending on whether an accrual based or a cash based approach is applied.
- *Primary balance*: The amount of the public debt may be influenced by the development of the primary balance, its distribution during the year and by the development of other factors modifying the financing requirements. This may at the same time constitute a financing risk. In terms of the distribution during the year some changes have taken place in comparison to the budget act - the first quarter deficit has been raised - but the annual estimates have not been changed.

By continuous monitoring of the net financing requirement and by timely recognition of the materialisation of any risk it is possible to modify the financing plan to ensure adequate financing at minimum costs and by assuming acceptable levels of risk.

Box 4.3

Sustainability of the public debt

Rather than its absolute amount, the sustainability of public debt is determined by its ratio relative to GDP and its changes. The debt rateóio should be of a level where it promotes the healthy growth of the economy without overburdening it.

According to the Maastricht Treaty (1993) the so-called Maastricht convergence criteria have to be met for accession to the Economic and Monetary Union and the introduction of the Euro. The values of the convergence criteria were established at a level where the satisfaction of the convergence criteria would have ensured the stability of the debt ratio on the basis of the economic status and condition of the Member States and their growth rates at that time . Economic growth however, declined later on. For this reason and in order to ensure meeting the original objectives the conditions were tightened in 1997 by the Stability and Growth Pact. According to the Stability and Growth Pact the goal now is to ensure a budgetary positionclose to balance or in surplus. In addition to ensuring that the deficit and the public debt do not exceed 3 % and 60 %, respectively, even in the case of negative effects on economic growth, the demanding of a close to balance position can also make it possible in a longer run to reduce the public debt to well below 60 % and keep it there. For Hungary and the rest of the new Member States this is also important because as a result of their structural features (state commitments in the case of bank crises, credibility concerns, debt stock increase caused by growing expenditures related to the ageing population and by economic convergence, turbulence in the foreign exchange market, growth shocks) a debt stock below 60 % is an optimum level for the economy in these countries. Furthermore, it is a prudent fiscal policy to ensure that any possible financial disturbances do not lead to a debt crisis. Though such problems may occur in more advanced economies as well, these tend to be more frequent and of a larger scale in the converging economies.

The relationships between the sustainable public debt, the deficit, the interest rates and economic growth and the primary balance may be summed up in a simplified way as follows:

- As a function of the debt ratio and growth it is possible to establish the still permissible general government deficit which still ensures long term stability of the debt ratio. (The sustainable deficit as a percentage of GDP is obtained by multiplying the debt ratio by a ratio whose numerator is the GDP growth rate and whose denominator is 1+ the growth rate).
- The following relationships apply to the primary balance:
  - If the GDP growth rate exceeds the real interest rate (in respect of the public debt), then:
    - in the case of a primary sufficit the debt ratio declines;
    - if the primary balance is negative the debt ratio increases only to a certain limit. (Indeed, it may even decline under certain circumstances, depending on the extent of the primary deficit)
  - If the GDP growth rate is below the real interest rate there is a need for a sufficit in the primary balance for the stability or decline of the debt ratio because:
    - in the case of a permanent primary deficit the debt ratio grows beyond any limit;
    - the debt ratio starts to decline only upon reaching a sufficient rate of primary sufficit.

4.2 Household savings[10]

Improved financing capability of households in 2004

In comparison to 2003 the financing capability of households improved in 2004, as a consequence of the decline of the demand for credit resulting from the tightening of the home financing scheme and the saving propensity enabled by the high yield level. The high HUF interest rates - besides having a positive effect on **savings** - also contribute to the growth of foreign exchange lending.

Foreign exchange borrowing increased substantially

Despite the declining demand for credit the household loan debt portfolio increase by HUF 953 billion last year (more than HUF 200 billion below the year 2003 increment of the household debt portfolio). As a consequence of the high interest rates on HUF loans the portfolio of foreign exchange debt of households increased. The share of foreign exchange loans within the total loan debt portfolio increased from 5 % at end-2003 to 15 % by the end of last year.

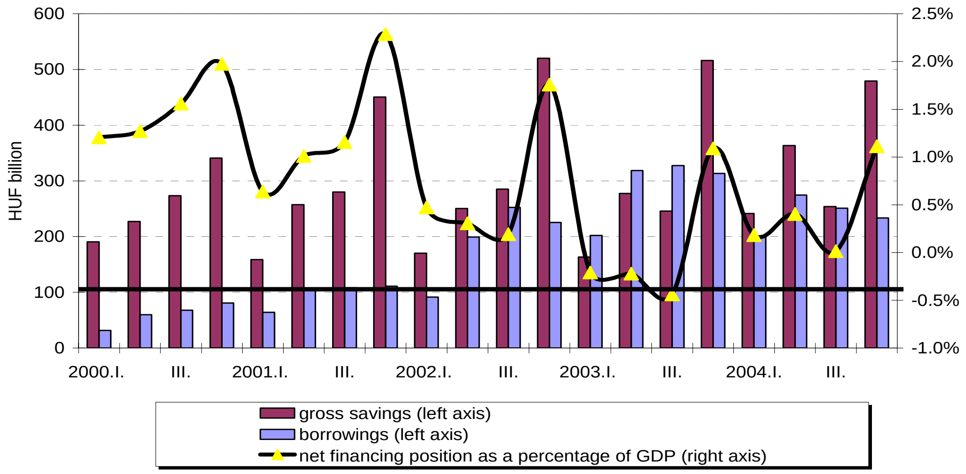
The substantial decline of the rate of the growth of real wages had a major impact on the development of savings: it resulted in a deceleration of the growth

[10] The data do not contain payments to mandatory pension funds - in concert with the general government methodology - for those do not constitute savings based on people’s discretionary decisions

of consumption - caused by increasing caution - and increasing cash savings. The growth of the propensity to save was significantly facilitated by the increase of other incomes of this sector (interests, Exchange price gains).

As a result of the slow-down of the growth of indebtedness and the increase of gross savings the net financing position of households increased last year to 0.9 % of GDP - or to 1.8 % of GDP without the effects of the pension reform.

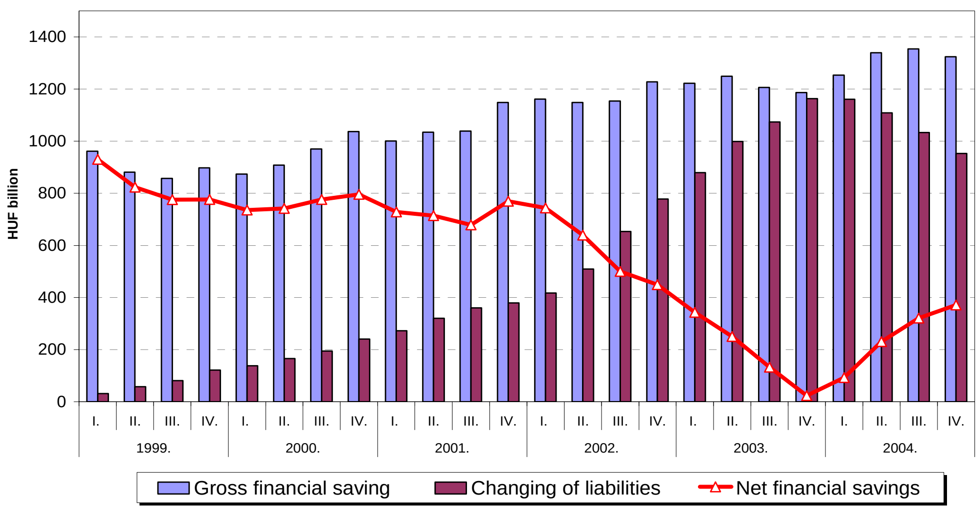
Development of the gross savings and borrowing of households and their net GDP proportionate financing position*



*For considerations relating to methodology the data do not include the effects of the pension reform

The strengthening of the net savings position is clearly illustrated by the 12 month accumulated figures: growth that commenced in the last quarter of 2003 continued steadily up to the end of 2004.

Development of net financing position of households
(12 months accumulated values of transactions)*



* For considerations relating to methodology the data do not include the effects of the pension reform

As a result of the acceleration of the growth of real wages - in comparison to 2004 - and the expected modest level of consumption, gross savings are expected to increase in 2005. The dynamic of lending will be determined primarily by the combined effect of the decline of interest rates entailed by the growth of macroeconomic stability and the demand increasing effect of the housing subsidy programme launched in early 2005 (*nest building programme)*. At the same time the growing indebtedness of the sector will be slowed down somewhat by the fact that the volume of the nominal interest expenditures on household liabilities amounted to as much as 5 % of household incomes and this ratio will continue to increase this year.

The net position may increase somewhat this year

In view of the above considerations the net position of the sector may reach 1 % of GDP this year - or about 2 % of GDP without the adjustment for the effects of the pension reform.

No material growth of household savings - such as the reaching of a high level that characterised the period before the end of the nineties - may be expected even in a longer run. The economy of Hungary is now witnessing the process that culminated about ten years ago in Portugal and Spain, where in parallel with the development of the economy and the improvement of the income positions and income expectations, households switched to a higher consumption and indebtedness path. Any material change may only be expected in the structure of savings. At present the largest part of the financial assets of households are kept in short term, relative low yield and low risk - so-called conservative - financial instruments. In parallel with the improvement of access to information on the money markets and the increasing of the risk taking propensity enabled by increasing incomes, interest in instruments offering higher yields at higher risks will increase in a longer run.

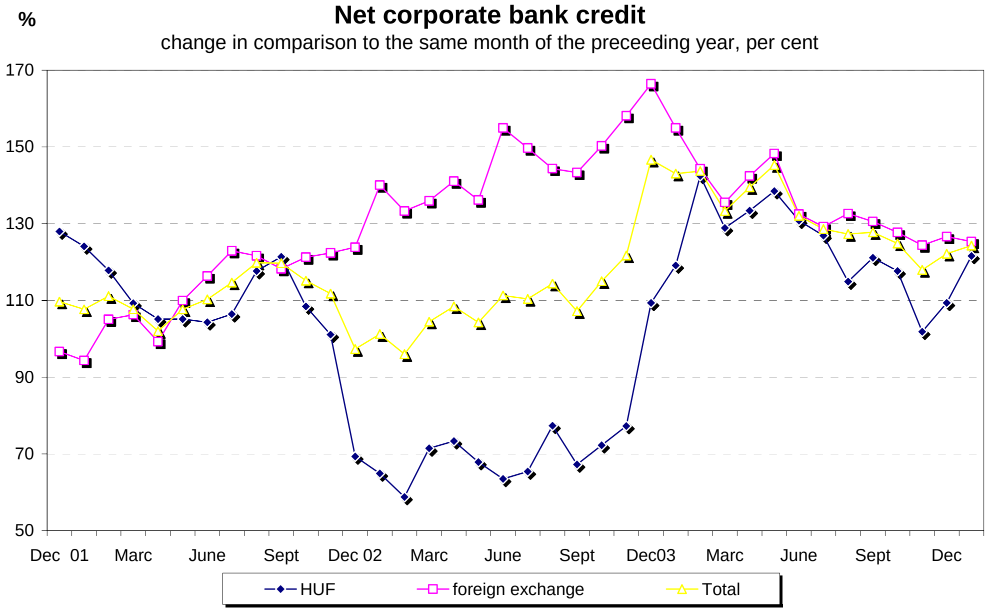
4.3 Corporate sector

Since the lowest point in 2002 when the corporate sector turned into a net lender the **financing need of businesses** has been increasing steadily each year. As a consequence of the favourable economic trend in 2004, the funding requirement of the business sector increased by more than 100 %.

The funding requirement of the business sector increased by more than 100 % in 2004

Almost three quarters of the nearly HUF 840 billion funding requirement as shown by financial accounts was covered by the net lending of HUF 610 billion, by the domestic banking system. Direct foreign borrowing amounted to HUF 156 billion: this was purely foreign direct investment since businesses reduced their net foreign debt by HUF 600 billion during the year.

The dominant role of domestic bank financing shows that despite the high domestic interest rates Hungarian banks managed in 2004 to maintain their competitiveness against foreign competitors. The structure of loan financing however, shows that this entailed a growth of the lower interest rate FX loan facilities.



Growth of share of foreign exchange loans on the increase

Particularly rapid growth was observed in the gross foreign exchange debt of businesses, its dynamic was almost three times that of HUF borrowing. The sector's net debt stock is also dominated by foreign exchange loans partly as a result of the smaller gross HUF loan debt stock and partly owing to the growth of the HUF deposits of businesses. In the fourth quarter only the stock of net foreign exchange loans increased.

The increasing foreign exchange indebtedness of the business sector weakened further the regulatory effect of the monetary policy - and the exceptionally high interest rates - at the same time however it contributed to the improvement of the financing structure of the deficit. Together with the growth of household foreign exchange loans the foreign exchange borrowings of businesses played a significant role in the maintenance of the demand for HUF and consequently in that of the strength of the HUF.

The particularly strong HUF rate prevailing through most of the year entails a significant exchange rate risk for the non-exporter groups of the business sector - owing to the significant foreign exchange loans - which may be alleviated by the application of various insurance facilities and hedging transactions.

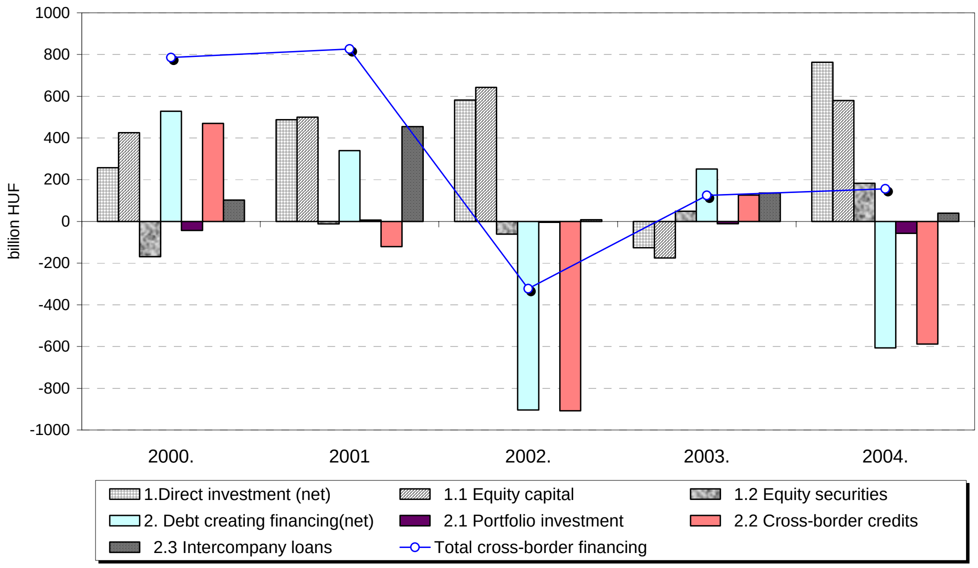
After a record low in 2002 the demand for direct foreign loans started to rapidly increase in 2003 besides the dynamic expansion of domestic foreign exchange lending. In addition to the effects of the high domestic interest rate levels this was also facilitated by the stability and level of the HUF rate in view of which the burdens and risks of foreign exchange borrowing were tolerable for businesses (based on suitable maturity periods and repayment terms).

Five year high influx of foreign direct investment

The continued strengthening of the HUF and the start of the decline of domestic interest rates as well as the favourable international investment climate eroded the intensity of the above process in 2004. Businesses substantially reduced their net foreign borrower positions by increasing their foreign lending while the influx of foreign direct investment soared to a five year high (equalling net HUF

762 billion).

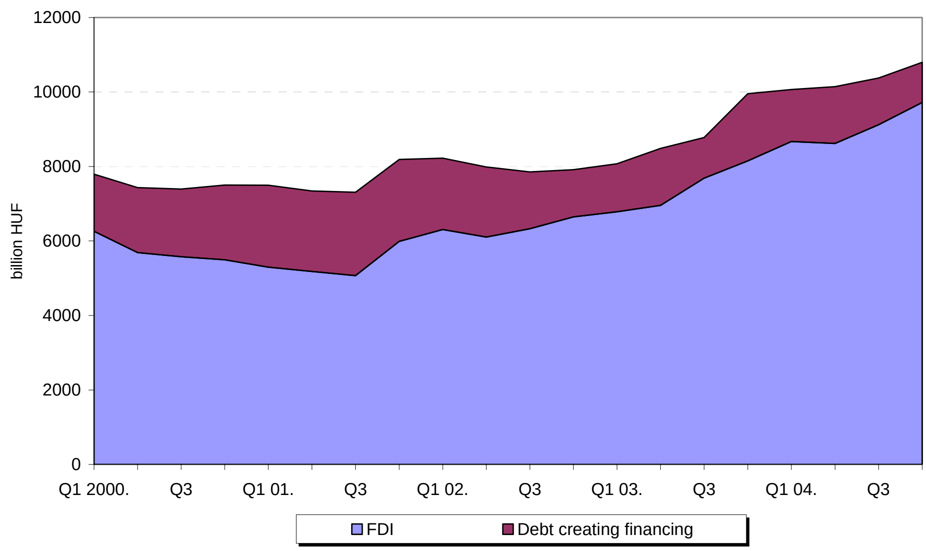
Development of corporate sector's financing from abroad



The lending operations of Hungarian businesses abroad have been growing rapidly for years now. This may be a result of the financial transactions of domestic large enterprises with foreign participation and of the growth of export financing, which may also be related to problems of competitiveness faced by exporting businesses.

Cross-border financing of businesses - which has been on the increase since 2003 - is a more favourable way of financing the deficit. An increase within this trend of the role played by non debt generating channels, is considered particularly favourable - and it has a positive effect on the equilibrium as well - in accordance with the trend observed in 2004.

The corporate sector's cross-border financing



In 2004 the 12 month dynamic of the growth of the securities portfolio of the entire business sector increased to 117 % (2003: 107%). The almost HUF 460 billion expansion however, originated from an increment of the investments of non-monetary financial corporations. Non-financial enterprises reduced their government security portfolios to an extent (by HUF 76 billion) that exceeded the growth of the portfolio of investment fund certificates by a wide margin. This decline materialized in a conversion of the investment portfolio into bank deposits which were highly attractive owing to the high level of interest rates but it is also possible that this was also used for increasing the funds required for the expansion of production and investment enabled by the economic upswing.

Finaning need expected to grow

Both the economic growth projections and the analyses of the processes of the financing channels show that the increase in activities of businesses should be expected to continue in 2005 - though at a less decreasing rate - which will continue to result in increasing demand for financing. The expected reduction of the difference between foreign and domestic interest rates and any possible increase of the exchange rate volatility may entail a growth of the share of HUF loans.

Domestic savings are still not expected to make a sufficient contribution to the satisfaction of the funding requirements of businesses, consequently, foreign sources will continue to play a significant role. The international financing conditions that are still considered favourable - though this is threatened to some extent by the fact that t interests rate hikes have started in the most advanced economies - are not expected to deteriorate during the year to an extent that would hinder the involvement of cross-border financing directly or via the banking system by the enterprises .

4.4 External equilibrium[11]

The dynamic of the growth of the deficit declined substantially because …

The **current account balances** show a substantial improvement of the economic structure, and the structure of financing has improved. The current deficit amounted at end-2004 to EUR 7.1 billion or 8.9 % of GDP. As a result of the ex-post adjustments the year 2003 current deficit was reduced by EUR 200 million to EUR 6.4 billion or 8.7 % of GDP. Though the deficit increased in 2004 by EUR 759 million over the amount recorded in 2003, yet the rate of the growth declined substantially (the increment in 2003 amounted to EUR 1.4 billion). The deterioration took place in the first three quarters of the year, while in the last quarter of 2004 the effect of income transfers deteriorating the equilibrium were fully offset by the improvement in the real economy.

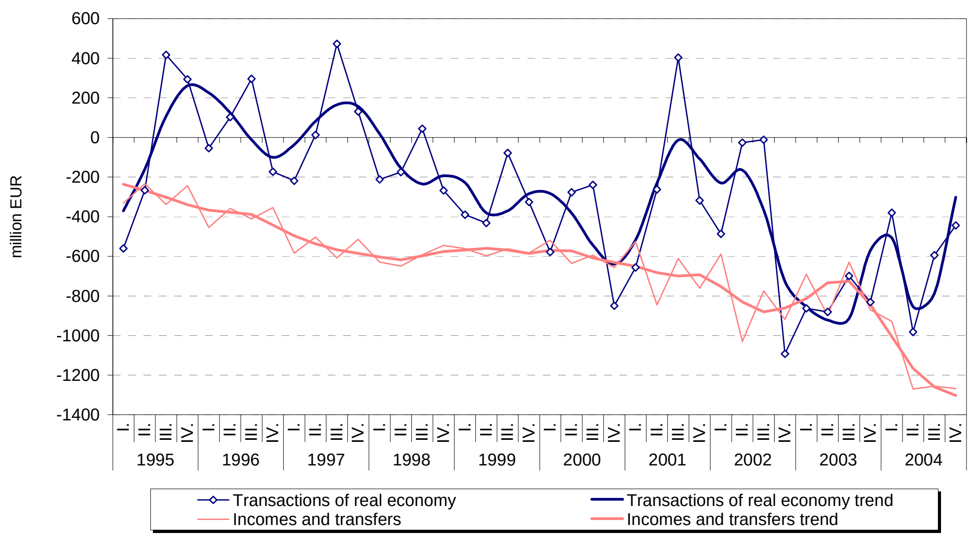
… the positions of transactions in the real economy

A definite improvement was observed in the transactions of the real economy - foreign trade and services - throughout the whole of the year. The growth of the external disequilibrium was a result of the increased outflow of incomes.

[11] In the wake of Hungary's EU accession the system of foreign trade statistics and its publication regime has altered. Technical factors relating to accession complicated the recording and evaluation of imports. Owing to the ex-post adjustment of foreign trade data, the change of the methodology of statistics on services, along with the questionnaire based processing of data on capital investment and incomes the NBH has carried out a revision of the period extending back to 2000.

improved

Transactions of real economy, incomes and transfers



As a result of the dynamic growth of exports[12] - exceeding that of imports - the foreign trade deficit declined by some EUR 500 million to about EUR 2.4 billion.

No turn-around in tourism, but declining deficit on other services

In contrast to the almost EUR 400 million deficit in 2003 services did not increase the external financing requirement in 2004. Within the category of services however, the share of revenues from tourism continued to decline. The sufficit of tourism dropped by EUR 300 million to EUR 962 million (in 2002 and 2003 it was EUR 1.7 billion and EUR 1.3 billion, respectively). In the case of other services the growth of export revenues made it possible to reduce the net expenditure surplus by EUR 700 million to EUR 1 billion. The deterioration of the net revenues of tourism was therefore over-compensated by the improvement of the position of other services. This is how the position of services as a whole could be improved by almost EUR 400 million in comparison to the level recorded in 2003.

Net income outflow increased to 6 % of GDP,…

The deterioration of the external equilibrium in 2004 was caused by the net income outflow of EUR 4.9 billion which equalled 70 % of the current account deficit (by EUR 1.2 more than in 2003). Three quarters of the EUR 3.7 billion income transfer related to non-debt type investments. Within this the category of re-invested earnings which do not constitute actual income withdrawal makes up some 50 % (EUR 1.9 billion). This is a natural and positive process, indicative of the favourable investment conditions in Hungary. Debt type - interest and interest type - payments increased by EUR 500 million, to EUR 1.4 billion, primarily in relation to the growth in the first three quarters of the government securities denominated in HUF, held by foreign investors, and the high rates of interest and yields. The EUR 126 million of compensation of employees improved the equilibrium. The importance of this latter item may increase in the future.

[12] Figures in the balance of payments are stated in EUR.

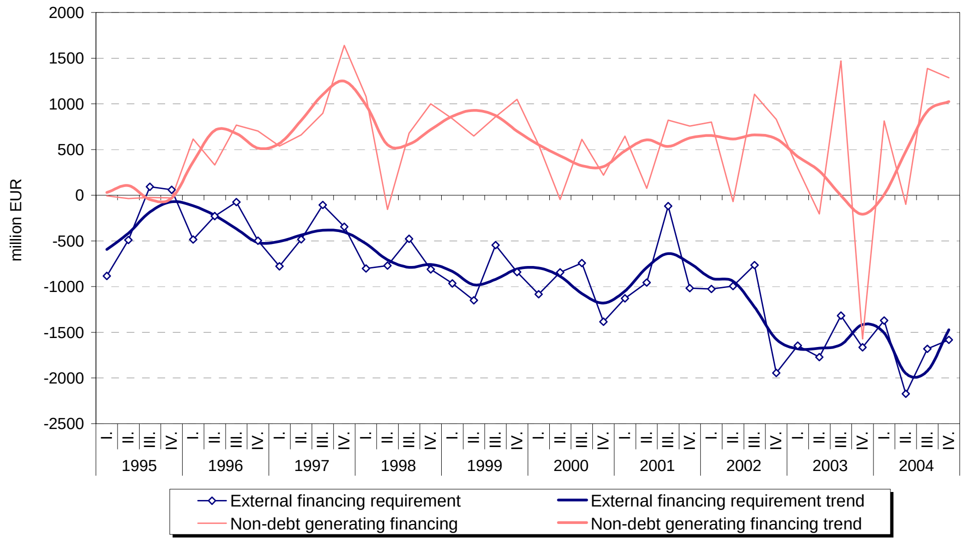
The net income surplus of current transfers (EUR 206 million) was down almost EUR 400 million from the basis figure and is a result of the payments entailed by Hungary's EU membership. For much of the EU transfers appear in the capital account.

…the role of current transfers in improving the equilibrium diminished

Instead of the EUR 32 million deficit of 2003 the **capital account** holds an EUR 318 sufficit in 2004. The net external financing requirement (the current account balance and the capital account together) stood at EUR 6.8 billion at end-December, some EUR 400 up on the basis, but as a percentage of GDP it dropped from the 8.6 % of 2003 to 8.5 % in 2004.

External financing requirement dropped to 8.3 % of GDP

External financing requirement and non-debt generating financing



The non-debt generating net capital influx amounted to EUR 3.4 billion, which covered almost 50 % of the net external financing requirement. At the end of September this ratio stood at 40 %. The equity capital, portfolio investment and equity securities amounted to EUR 3.8 billion - in contrast to the 1.4 billion in 2003. At the same time the placements of residents declined to 29 % of the previous year's figure. A quarter of the position improvement originated from the growth of portfolio investments, indicating an increase of interest in the Stock Exchange. This capital channel of a somewhat more hectic nature made up similar share of the non-debt generating net capital influx as well.

Non debt generating net capital influx financed 50 % of the net external financing requirement

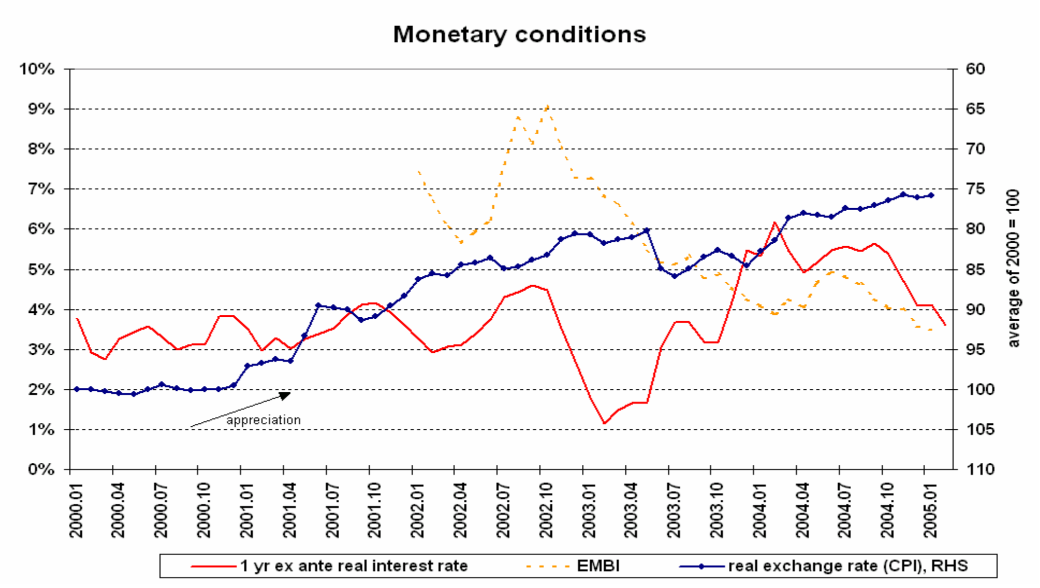
The portfolio of international reserves amounted to EUR 11.7 billion at the end of December.

The **gross debt stock of the national economy** amounted to EUR 56.8 billion, equalling 70 % of GDP. Within this the debt of the general government system and the NBH equalled 30 % of GDP. In comparison to the figure recorded at the end of 2003 the gross debt increased by EUR 9.2 billion, some 60 % of which affected the private sector. The net debt stock amounted to EUR 25.4 billion at the end of December, EUR 4.1 billion up on the end-2003 figure. The increment is, in essence, the net indebtedness of the general government system and the NBH.

5. Monetary developments

5.1 Monetary conditions

The harmony between fiscal and monetary policy which was upset during previous years was not fully restored in 2004 either. In comparison to the tightening of the fiscal and the income policy it should be noted that year 2004 was characterised by **tight monetary conditions.** The consumer price based real exchange rate continued to appreciate - from an originally strong level in comparison to the year 2000 average - and real interest rates fluctuated at 5-6%, well above the band that had prevailed earlier.

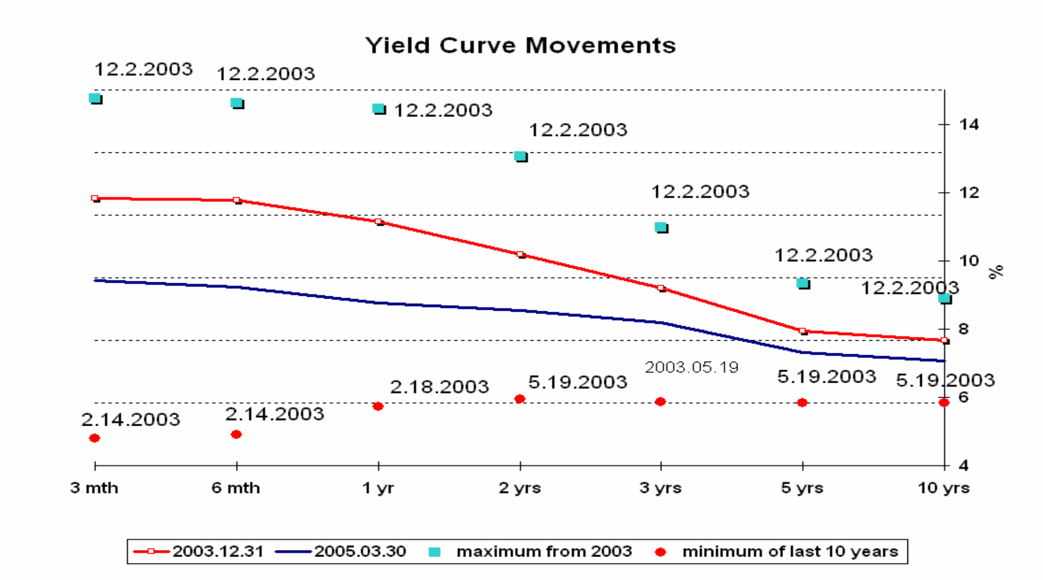


The risk taking propensity of investors was outstanding - the EMBI index measuring the risk premium of the emerging markets dropped to a multiple year low - the atmosphere among international investors and particularly the views taken of our region is highly favourable. This has enabled other countries to keep interest rates low and at the same time it contributed to the substantial appreciation of the currencies of the region. Over recent years however, despite the significant reduction of the EMBI index, the premia on Hungarian investments stood at much higher levels - moving on a different path - as an indication on the one hand of the earlier loss of credibility of the domestic economic policy and, on the other hand, of the tight central bank policy in the case of short term yields. There is also a risk of a change of the international investors' atmosphere having a contrary influence despite the improvement of domestic economic conditions. Nonetheless, the accomplishment of the 2005 fiscal targets and the budget to be adopted along the principles laid out in the convergence programme may result in a marked improvement of the views taken of Hungary by international investors. Any material decline of the expected yield premia will of course demand adaptive interest policy steps by monetary policy, indeed, in some circumstances even preventive steps may be necessary. An additional material reserve for the improvement of confidence in economic policy and thereby for the reduction of the debt burdens lies in the strengthening of the dialogue among the institutions dominating economic policies and in improved coordination between fiscal and monetary policies.

Inconsistencies in economic policies in Hungary have diminished but in early 2004 still quite a number of uncertainties prevailed. The raising of indirect tax rates in 2004 could - in theory - cause only a temporary growth of inflation but in early 2004 it was an open question as to what part of the temporary increase of inflation would be integrated in the inflationary expectations leading to a more permanent price increase. The markets saw substantial risks in respect of the feasibility of the budget deficit target modified in early 2004. The unfavourable views must have been strengthened by the fact that the development of the deficit during the year was highly uneven: in the first half the - targeted and then realised deficit - was much higher than the proportionate amount. The other equilibrium indicator which is considered as essential by investors - the current account deficit - was high in the first half of the year and only a slow decline could be expected.

As a consequence of the above processes it can be declared that both external and internal conditions called for tighter than neutral monetary conditions in early 2004. Monetary however kept the interest rate level high and during the year base rate cuts followed the diminishing of risks only at a certain lag.

The second half of 2004 saw a substantial decline of the yield levels on the long side of the yield curve as well, as an indication of the recovery of investors' confidence. The spread of Hungarian government securities over the Euro declined both in the case of the securities denominated in HUF and those in FX. The base rate applied by the central bank declined somewhat faster than at the beginning of the year but still not as fast as would have been justified. Meanwhile the real exchange rate kept strengthening throughout the year in which the inflationary difference also played a role besides nominal appreciation.



In early 2005 - in an international environment which was even more favourable than before - the decline of the base rate and the whole yield curve continued in Hungary. The market was expectant of regular interest rate cuts (the difference between the 3 month yield and the base rate varied between 50 and 100 basis points) and the central bank kept following the expectations. The equilibrium interest rate level shows the position of the Hungarian macro-economy, its catching-up status, its high capital requirement in comparison to the domestic savings, the continued need for disinflation and the requirements stemming from accession to the Euro zone.

In view of the developments in the financial markets in early 2005 the year 2004 monetary policy is considered to have been tight: the reduction of inflation was faster than expected, the ex post real interest rate increased particularly high and the exchange rate of the HUF got very close to the edge of the band. This latter imposes excessive burdens on the real economy and it significantly reduces the room for manoeuvre of monetary policy.

5.2 Development of the exchange rate

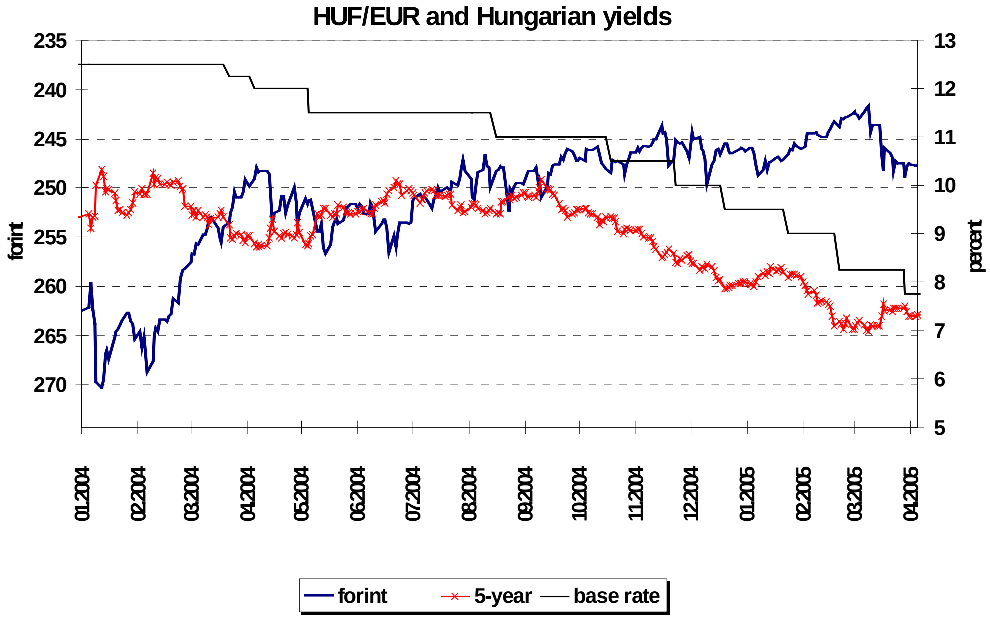
The exchange rate regime applied made an inconsistent contribution to the attainment of the goals

At the introduction in 2001 of the current wide band exchange rate regime with a fixed central parity the key objectives included the attainment of macroeconomic stability and effective promotion of the curbing of inflation. Ultimately, the exchange rate regime has contributed to the attainment of the goals so established, at the same time, some of its unfavourable features have also emerged as a result of its pegged nature. In a liberalised international financial environment it became an increasingly frequent target of speculation and the contradictions of the system - which existed right from the inception - also grew increasingly evident. This was strengthened by the occasional inconsistencies of the economic policies and by inadequate communication.

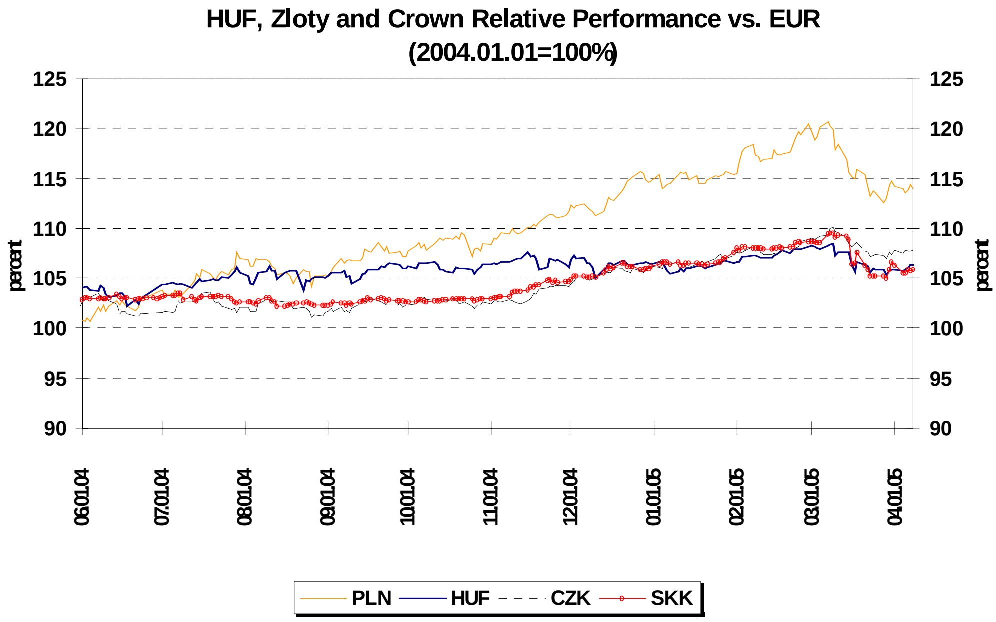
Exchange rate is strong and stable

From end 2003 the positive changes in the economic fundamentals and the improving perception taken of the economy of Hungary by the money markets have gradually appeared in the development of the exchange rate as well. The volatility of the **exchange rate** declined substantially up to May 2004, and since early July 2004 the rate has been characteristically stronger than the 250 HUF/EUR level. The favourable international and regional environment also contributed to the stability of the exchange rate. The strong and stable exchange rate greatly facilitated the spectacular success in reducing the rate of inflation but it had a negative impact on the competitiveness of the economy, as is indicated by the slow-down of the growth of investment, export and the economy in the second half of the year. According to analysts' expectations disclosed in the latest Reuters poll of 25 March, the exchange rate will continue to be strong (around 253-254 HUF/EUR) during the whole of the period up to 2006, along with lower than the existing interest levels.

.



In comparison to the development of the exchange rates of the Czech, the Slovak and the Polish currencies the HUF was more stable during much of 2004. It is also clear that the exchange rates of each currency strengthened substantially after the first quarter of 2004, though to different extents and at different times. The zloty strengthened particularly notably. During the past weeks owing to the rising yields in the US some minor adjustments took place in the exchange rates.



Development of competitiveness is only partly reflected by real effective exchange rate indices

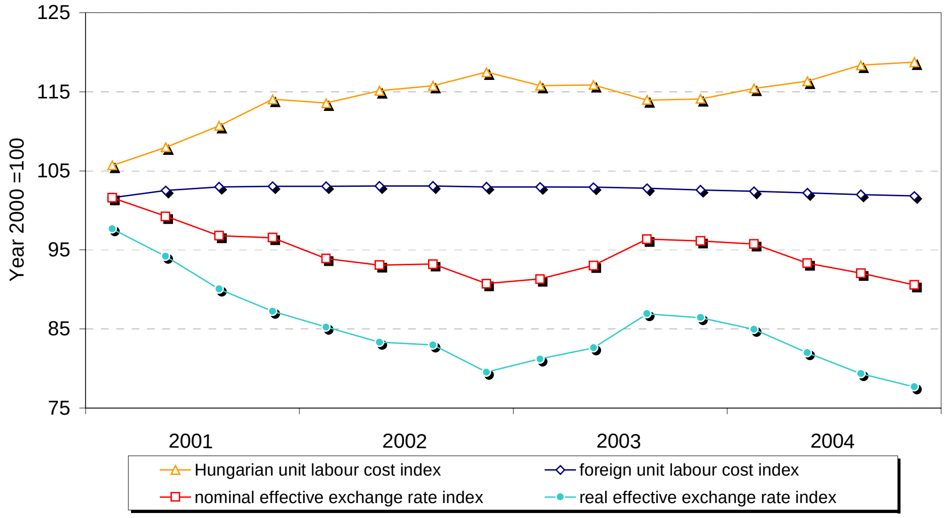
Conclusions from measurement of competitiveness based on the real effective exchange rate indices calculated on the basis of costs and prices may only drawn with a measure of caution in the case of the economy of Hungary. The reason for this lies in the structure of the economy. In areas playing major roles in exports - such as the manufacturing industry - there are quite a number of multinational enterprises in Hungary which purchase much of their inputs required for production abroad and which sell most of their output abroad. It is quite evident that in this category competitiveness is only slightly influenced by the development of domestic prices and costs. It should also be noted that the development of competitiveness in a broad sense is influenced by consistent economic policies ensuring the sustainable growth of the economy and a business friendly economic environment. A positive change has been perceived during the recent period in this field.

Competitiveness deteriorating again after a temporary improvement

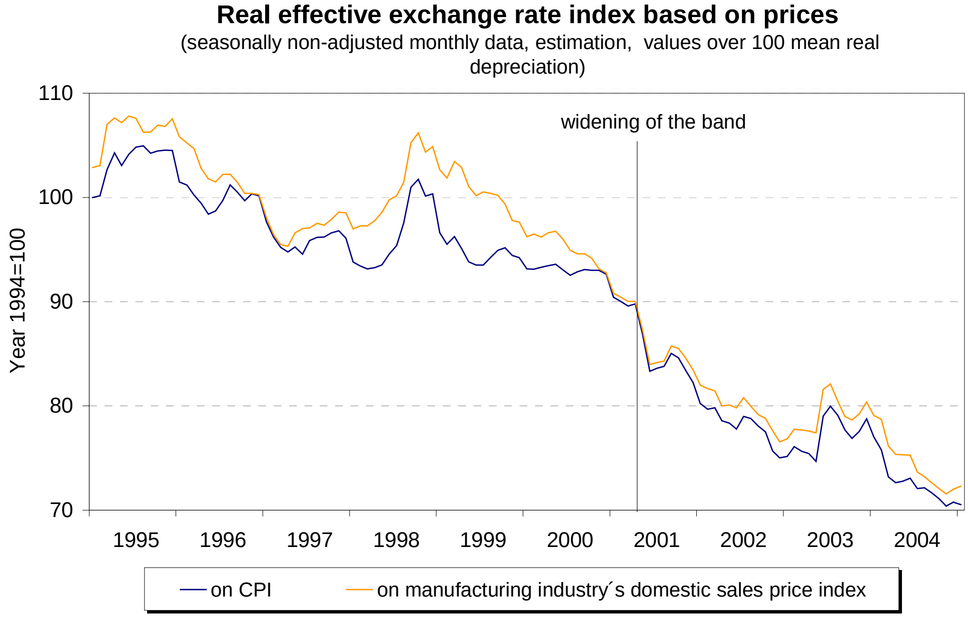
Year 2001 and 2002 saw a dramatic deterioration of the price and cost based competitiveness (by 16 % and 17 %, respectively). The deterioration of competitiveness slowed down gradually in 2003 and as an average of the year the price based competitiveness declined slightly while cost competitiveness improved somewhat. Competitiveness started to decline again in 2004 to a large extent owing to the strengthening of the exchange rate. In the past years besides the improvement of the nominal exchange rate the dominant factor of real appreciation was the substantially faster increase of wages than the modest growth of productivity.

Real effective exchange rate index based on unit labour cost of manufacturing industry

(seasonally adjusted quarterly data, values over 100 mean depreciation)

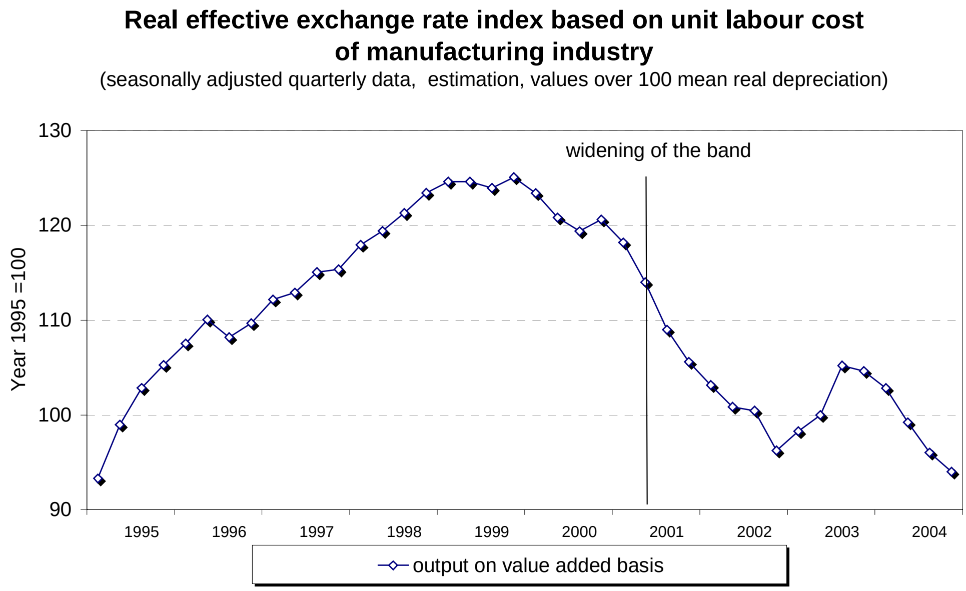


In the case of an economy in the process of catching up rapid growth is naturally accompanied by real equilibrium appreciation calculated on the basis of the consumer price index. This however, over a longer period, may not exceed 1-2 % a year. In 2004 this index was much higher, about 6 % as the average of the year, owing to the strengthening of the HUF and the temporary increase of inflation. In 2005 however, owing to the significant decline of the inflation difference in comparison to our major trading partners, the real appreciation based on the consumer price index is not expected to exceed the typical long term rate.



In the case of a small, open, quickly growing economy the development of cost competitiveness gives a better view of the development of competitiveness than price competitiveness. In this field, in terms of the annual average, a substantial - 4% - decline was observed last year, after the improvement in 2003. The trend within the year was also unfavourable partly as a result of the strengthening of the exchange rate because of the growth of productivity and wage outflow has become more closely coordinated. No improvement is expected this year in the cost competitiveness again, unless the exchange rate weakens somewhat.

Trend deteriorating in the case of cost competitiveness as well



Based on a comparison of the Polish, Czech, Slovak and Hungarian real effective exchange rate indices a substantial deterioration of the Hungarian competitiveness is identified, with the price based competitiveness developing

Comparison to Visegrád countries in terms of more unfavourably than in Hungary only in Slovakia. The unit labour cost based index which gives a better view of the development of competitiveness has been developing most unfavourably in Hungary and though this index has been declining in the other countries as well, in their case the deterioration starts from a much better basis.

competitiveness does not give a positive picture either

Budapest, 6 April 2005

Table 1.

ECONOMIC INDICATORS

Real Sector, Prices, Competitivness

change from the same period of the previous year, %

	2000	2001	2002	2003	2004												2005	
	I-IV. quarter	I-IV. quarter	I-IV. quarter	I-IV. quarter	1. month	1 - 2 month	I. quarter	1 - 4 month	1 - 5 month	I. half of year	1 - 7 month	1 - 8 month	I-III. quarter	1 - 10 month	1 - 11 month	I-IV. quarter	1. month	38354,0 month
GDP volume	5,2	3,8	3,5	3,0	-	-	4,3	-	-	4,2	-	-	4,1	-	-	4,0	-	-
Household consumption	5,0	5,9	9,3	7,6	-	-	3,3	-	-	3,5	-	-	3,4	-	-	2,8	-	-
Gross fixed capital formation	7,7	5,0	8,0	3,4	-	-	18,9	-	-	13,5	-	-	13,2	-	-	8,3	-	-
Exports of goods and services	21,0	7,8	3,7	7,6	-	-	18,0	-	-	18,4	-	-	15,4	-	-	15,7	-	-
Imports of goods and services	19,4	5,1	6,2	10,4	-	-	16,7	-	-	18,6	-	-	16,0	-	-	14,0	-	-
Volume of retail trade turnover 14/	2,0	5,4	10,7	8,4	5,7	5,0	5,2	6,6	6,6	7,4	6,9	6,6	6,4	6,1	5,9	5,6	2,2	-
Volume index of investments	6,5	3,5	5,8	3,4	-	-	18,9	-	-	13,5	-	-	13,2	-	-	7,8	-	-
Foreign trade turnover: export volume	21,7	7,8	6,8 /12	9,1	19,9	20,6	20,1	18,4	18,2	20,4	19,7	19,0	18,0	17,5	17,6	16.9*	9.4*	-
import volume	20,8	4,0	6,1 /12	10,1	12,0	13,7	16,1	18,2	16,9	18,2	16,4	15,9	15,8	15,0	14,8	13.8*	10.8*	-
Volume of industrial production	18,2	3,6	2,8	6,4	7,2	9,8	10,4	10,4	9,8	10,4	9,5	9,2	8,9	8,5	8,7	8,3	2,7	-
Volume of construction-installation activities	7,6	8,3	17,8	2,0	18,5	17,4	15,5	12,7	8,4	7,6	8,0	7,6	6,4	6,3	7,0	6,8	7,9	-
Number of employees (in thousands)																		
household survey (annual average)	3 849,1	3 859,5	3 870,7	3 921,9	3 884,1	3 890,1	3 891,5	3 889,1	3 888,9	3 892,8	3 893,7	3 894,6	3 897,4	3 900,0	3 900,1	3 900,4	3 864,3	3858,9
labour statistics 2/	2 718,1	2 720,8	2 726,1	2 752,8	2 763,3	2 764,7	2 768,6	2 774,2	2 779,6	2 784,2	2 787,3	2 789,4	2 791,5	2 792,5	2 792,3	2 789,6	2 769,6	-
Vacancies (in thousands) 3/	39,2	37,3	34,0	44,0	38,2	51,3	56,3	59,3	58,1	54,9	51,5	49,8	46,9	45,1	36,8	30,7	34,1	-
Number of unemployed (in thousands) 3/	372,0	342,8	344,9	359,9	388,0	401,7	396,9	378,4	361,6	350,7	360,4	361,4	364,9	368,1	378,7	400,6	430,3	-
Rate of unemployment (household survey, %)	6,4	5,7	5,8	5,9	6,3	6,2	6,1	6,1	6,0	6,0	6,0	6,0	6,0	6,1	6,1	6,1	7,2	7,0
Consumer price index	9,8	9,2	5,3	4,7	6,6	6,9	6,8	6,8	7,0	7,1	7,1	7,1	7,0	7,0	6,9	6,8	4,1	3,6
Index of industrial domestic sale prices	14,5	9,4	1,6	5,0	7,3	7,2	7,2	7,5	8,0	8,2	8,4	8,4	8,5	8,6	8,5	8,4	10,6	10,3
Index of industrial export sale prices	8,5	1,5	-4,5	0,3	3,9	3,1	2,1	1,9	1,8	1,3	0,8	0,4	0,2	0,1	-0,1	-0,4	-1,3	-1,6
Agricultural production prices	22,5	4,9	-1,1	5,3	14,4	14,9	14,5	13,5	15,5	14,7	7,6	5,9	3,4	-0,5	-3,9	-5,4	-	-
Competitiveness 10/																		
based on manufacturing prices	-5,4	-9,0	-7,9	-1,0	2,9	2,1	0,7	-0,2	-0,7	-1,9	-3,2	-3,9	-4,4	-4,8	-5,2	-5,7	-8,6	-
based on CPI	-1,8	-7,6	-9,1	-1,3	2,5	1,0	-0,4	-1,2	-1,5	-2,5	-3,6	-4,3	-4,7	-5,0	-5,4	-5,8	-8,4	-
based on ULC (value added)	-2,8	-7,8	-10,3	1,8	.	.	4,6	.	.	1,9	.	.	-1,8	.	.	-3,9	.	.

Table 2.

ECONOMIC INDICATORS

Income and Monetary Aggregates

change from the same period of the previous year, %

		2000.	2001	2002	2003	2004												2005	
		I-IV. quarter	I-IV. quarter	I-IV. quarter	I-IV. quarter	1. month	1 - 2 month	I. quarter	1 - 4 month	1 - 5 month	I. half of year	1 - 7 month	1 - 8 month	I-III. quarter	1 - 10 month	1 - 11 month	I-IV. quarter	1. month	1 - 2 month
Average earnings:	gross /1	13,5	18,0	18,3	12,0	8,0	8,4	9,4	9,1	8,6	8,6	8,2	8,0	7,9	7,6	7,3	8,2	6,9	-
	net /1	11,4	16,2	19,6	14,3	6,9	7,2	8,0	7,8	7,4	7,4	7,1	7,0	6,9	6,6	6,4	7,1	8,9	-
Household	savings (HUF billion)	1 032,3	1 146,9	1 220,1	1 184,3	-	-	229,2	-	-	590,0	-	-	845,0	-	-	1 324,2	-	-
	credits (HUF billion)	240,6	379,3	778,2	1 163,3	-	-	201,5	-	-	467,6	-	-	719,3	-	-	953,1	-	-
General government GFS balance (HUF billion) 4/		-480,2	-444,0	-1 685,6	-1 094,5	-218,8	-341,3	-434,7	-547,6	-722,4	-1 040,2	-1 072,3	-1 192,3	-1 284,2	-1 328,6	-1 435,1	-1 284,1	-198,4	-393,9
Central budget	GFS balance (HUF billion) 4/	-368,7	-402,9	-1 469,6	-732,4	-173,9	-246,7	-364,9	-426,9	-508,8	-855,5	-863,1	-926,8	-1 035,8	-1 034,6	-1 023,0	-889,0	-199,1	-379,0
	primary balance (HUF billion)	329,7	212,7	-832,0	-4,1	-141,5	-108,7	-186,3	-141,2	-169,8	-398,0	-369,2	-350,3	-412,8	-333,2	-262,6	-87,5	-167,7	-217,4
	revenue change 4/	14,2	10,5	7,1	13,3	-11,7	5,5	8,1	7,3	5,8	5,6	3,3	4,0	4,9	5,8	7,8	8,2	26,7	19,6
	expenditure change 4/	13,7	10,4	30,4	-2,7	20,7	16,4	17,3	17,0	16,9	19,4	17,4	16,0	15,4	14,5	13,2	9,9	23,2	27,6
Social Security Funds 5/: balance		-81,4	-28,8	-100,9	-349	-59,0	-115,3	-91,3	-146,5	-236,2	-208,2	-246,7	-301,4	-284,5	-339,3	-458,2	-422,9	-9,8	-38,4
	revenue change	10,7	18,6	17,2	4,5	4,3	4,1	8,5	8,8	8,5	9,5	16,2	9,6	10,1	9,8	9,8	7,7	24,4	26,8
	expenditure change	12,5	14,9	20,4	14,2	10,1	9,0	9,2	7,2	11,9	11,1	16,2	10,4	10,2	10,1	8,0	9,6	2,1	6,6
Government paper benchmark yields (average annual) 6/																			
	3 month	11,80	9,80	8,24	12,16	12,21	12,58	12,10	11,58	11,35	11,46	11,43	11,12	10,96	10,54	9,88	9,11	8,84	8,23
	12 month	11,57	9,21	7,95	12,03	11,85	12,49	11,20	10,68	10,67	11,07	10,96	10,70	10,78	10,26	9,52	8,67	8,5	7,51
	3 year-bonds	10,74	8,17	7,37	10,16	10,29	11,16	10,36	9,71	10,12	10,60	10,61	10,11	10,40	9,75	9,08	8,49	8,11	7,93
	5 year-bonds	9,11	7,72	7,00	9,27	9,23	9,91	9,34	9,14	9,46	9,36	9,62	9,48	9,51	8,93	8,33	7,86	8,19	7,18
	10 year-bonds	9,04	7,06	6,44	8,02	8,13	8,75	8,22	8,19	8,44	8,46	8,40	8,36	8,58	7,95	7,47	7,06	7,39	6,62
	15 year-bonds	0,00	6,68	-	-	-	8,21	-	7,44	8,04	-	8,28	-	8,25	-	7,46	-	6,8	-
Interest rates 6, 7/:																			
with maturity less than a year	credit	12,8	11,2	9,7	13,39	13,53	13,56	13,54	13,40	12,80	13,30	13,14	13,25	12,94	11,88	11,56	10,99	10,37	9,94
	deposit	9,5	8,4	7,4	10,96	11,06	11,07	11,22	11,20	10,60	10,60	10,70	10,35	10,34	10,21	9,54	9,09	8,55	8,01
with maturity more than a year	credit	13,4	11,2	9,7	13,04	13,84	13,88	13,49	13,40	13,40	12,20	13,37	13,24	12,88	12,12	7,14	11,22	10,45	11,02
	deposit	9,4	7,7	8,0	10,80	9,10	7,40	8,00	10,80	10,30	10,70	10,30	9,76	10,04	9,37	9,14	8,25	7,53	6,98
Increase of money supply 8/		12,9	17,2	18,9	10,1	15,7	8,4	5,5	10,7	11,7	14,0	13,4	11,1	9,4	9,7	11,1	10,3	13,0	16,1
Current account of balance of payments (mEUR)		-4 352	-3 577	-4 929	-6 364	-302	-790	-1 308	-2 341	-	-3 561	-	-	-5 411	-	-	-7 123	-	-
Without reinvested earnings		-3 281	-2 049	-3 046	-4 649	-121	-427	-842	-1 930	-	-3 599	-	-	-4 538	-	-	-5 249	-	-
Net foreign debt denominated in foreign currencies (bEUR) 9/		7,4	4,5	5,5	8,0	.	.	8,6	.	.	9,8	-	-	9,9	-	-	10,8	-	-
BUX index 3/		7 865	7 122	7 739	9 627	10 064	10 242	10 992	11 072	11 285	11 537	11 680	12 171	12 647	13 201	14 194	14 742	15 553	18 383

METHODOLOGICAL REMARKS

for Table 1 and 2

Signs: * Preliminary data; **.** : data is not available yet; **-** : no data for the period

1/ Data for December 2004 and 2005 are adjusted for the effect of the change of the one month bonus payout in the public sector, MoF estimate
2/ Data for firms with more than 5 employees and for budgetary institutions total.
3/ End of period data.
4/ Excluding privatization receipts and contributions paid into the compulsory funded pension funds.
At the general government the interim data do not include the local governments.
5/ Total revenues and expenditures of the Pension Fund and Health Fund are not consolidated
with the non-self-provided services.
6/ The yield or interest in the last month of the period.
7/ At deposits with maturity longer than a month but not longer than a year.
8/ M3 does not include deposits with an agreed maturity over 2 years and debt securities with over 2 years' agreed maturity issued by motetary financial institutions. However, it includes holdings by residents other than monetary financial institutions of MNB bonds with up to 2 years' agreed maturity plus holdings by residents other than monetary financial institutions of investment units issued by money market funds.
9/ Excluding intercompany loans
10/ Price based indicators seasonally non-adjusted, unit labour cost based indicators seasonally adjusted
11/ As a consequence of correction of short term credits the net foreign debt has changed.
12/ There is a change in the statistical methodology from December 2002, therefore the CSO corrected only the annual volume indices.
According to the CSO publication exports went up by 5,9 % while imports increased by 5,1 % in 2002.
13/ Without part-time employees
14/Including sales of motor vehicles and antomative fuel